

8/15/77 [2]

Folder Citation: Collection: Office of Staff Secretary; Series: Presidential Files; Folder: 8/15/77
[2]; Container 37

To See Complete Finding Aid:

http://www.jimmycarterlibrary.gov/library/findingaids/Staff_Secretary.pdf

WITHDRAWAL SHEET (PRESIDENTIAL LIBRARIES)

FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
memo	From Brzezinski to The President (1 page) re: U.S. Position on Cyprus Succession	8/15/77	A

FILE LOCATION

Carter Presidential Papers- Staff Offices, Office of the Staff Sec.- Pres. Hand-writing File 8/15/77 [2] BOX 44

RESTRICTION CODES

- (A) Closed by Executive Order 12356 governing access to national security information.
- (B) Closed by statute or by the agency which originated the document.
- (C) Closed in accordance with restrictions contained in the donor's deed of gift.

THE WHITE HOUSE
WASHINGTON

August 15, 1977

Jody Powell -

The attached was returned in
the President's outbox. It is
forwarded to you for appropriate
handling.

Rick Hutcheson

Re: President's Reorganization
Project

THE WHITE HOUSE
WASHINGTON

	FOR STAFFING
	FOR INFORMATION
X	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

ACTION
FYI

	MONDALE
	COSTANZA
	EIZENSTAT
	JORDAN
	LIPSHUTZ
	MOORE
X	POWELL
	WATSON
	LANCE
	SCHULTZE

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER

Comments due to
Carp/Huron within
48 hours; due to
Staff Secretary
next day

	ARAGON
	BOURNE
	BRZEZINSKI
	BUTLER
	CARP
	H. CARTER
	CLOUGH
	FALLOWS
	FIRST LADY
	HARDEN
	HUTCHESON
	JAGODA
	KING

	KRAFT
	LINDER
	MITCHELL
	MOE
	PETERSON
	PETTIGREW
	POSTON
	PRESS
	SCHLESINGER
	SCHNEIDERS
	STRAUSS
	VOORDE
	WARREN



PRESIDENT'S
REORGANIZATION
PROJECT

WASHINGTON, D.C. 20503

THE PRESIDENT HAS SEEN.

*Today -
Max PR all
along
J*

EXECUTIVE COMMITTEE MEETING

August 15, 1977

Agenda

- | | | |
|------|---------------------------------|---|
| I. | Introduction | Jim McIntyre |
| II. | The Reorganization Agenda | Harrison Wellford |
| III. | Selected Topics | Harrison Wellford
Peter Szanton
Wayne Granquist |
| | A. EOP Implementation | |
| | B. Education | |
| | C. Defense Reorganization | |
| | D. Personnel Management | |
| | E. Advisory Committee Reduction | |
| | F. Regulatory Reform | |
| | G. Statistical Organization | |

AS2

**Electrostatic Copy Made
for Preservation Purposes**

President's Reorganization Project

AGENDA

August 1, 1977

Exhibit 1
page 1 of 1

Area	Work Underway	Proposed Projects Early Start	Projects for Later Initiation
Economic Development	Community and Local Economic Development Workplace Safety and Health (joint with Labor)	Economic Analysis and Policy Machinery Food and Nutrition Policy	Transportation Policy Financial Institution Regulation (joint with CEA and Treasury)
General Government	Border Management (joint with ODAP) Law Enforcement Small Agency Reduction Civil Rights	Federal Legal Representation Improvement of Justice System	Government Corporations
Human Resources	Education Human Services Programs ERISA (joint with Labor and Treasury) Welfare Organization (joint with HEW and Labor) National Health Insurance Organization (joint with HEW)		Cultural Programs Health Resources Development and Delivery Biomedical Research
Natural Resources	Toxic Substances (joint with CEQ)	Natural Resources and Environment (previously submitted) Federal Preparedness and Response to Disaster	Federal Research Development
National Security and International Affairs	Classification of National Security Documents (PRM 29)		Defense Management Structure National Military Command Structure Defense Resource Management Foreign Policy Management Peace Corps
Management Improvement	Statistical Organization Intergovernmental Management Circulars Administrative Services Delivery (GSA) Advisory Committee Reduction Automated Data Processing Federal Personnel Management (CSC) Federal Regional Operations Paperwork Reduction Grant Planning Requirements	Federal Cash Management	Citizen Participation in Federal Decisionmaking
Regulatory Reform	Surface Transportation Reform (joint with DOT) Economic Impact Analysis (joint with EPG Task Force) Consumer Functions (joint with Special Assistant to the President for Consumer Affairs and Domestic Policy staff)	Reform of Regulatory Procedures (previously submitted) Food Inspection and Labeling (incorporated in Food and Nutrition Policy issue)	Insurance Regulation Reform

THE WHITE HOUSE
WASHINGTON

August 15, 1977

Stu Eizenstat
Jim McIntyre

The attached was returned in
the President's outbox. It is
forwarded to you for appropriate
handling.

Rick Hutcheson

cc: Jack Watson

RE: MEETING WITH ALAN BOYD

THE WHITE HOUSE
WASHINGTON

	FOR STAFFING
	FOR INFORMATION
X	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

cc Jim McIntyre

ACTION	FYI
X	
X	

MONDALE
COSTANZA
EIZENSTAT
JORDAN
LIPSHUTZ
MOORE
POWELL
WATSON
LANCE
SCHULTZE

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER

Comments due to
Carp/Huron within
48 hours; due to
Staff Secretary
next day

	ARAGON
	BOURNE
	BRZEZINSKI
	BUTLER
	CARP
	H. CARTER
	CLOUGH
	FALLOWS
	FIRST LADY
	HARDEN
	HUTCHESON
	JAGODA
	KING

	KRAFT
	LINDER
	MITCHELL
	MOE
	PETERSON
	PETTIGREW
	POSTON
	PRESS
	SCHLESINGER
	SCHNEIDERS
	STRAUSS
	VOORDE
	WARREN

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

August 12, 1977

11:45 AM

cc: Stu -
Jim McG
follow up
J

MEMORANDUM FOR:

THE PRESIDENT

FROM:

STU EIZENSTAT

SUBJECT:

Meeting with Alan Boyd

At his meeting with you on Monday August 15 Alan Boyd wants to discuss the administrative structure for future international air negotiations. In the attached paper Boyd criticizes the present interagency coordination mechanisms. He recommends centralizing responsibility for future negotiations under a high-ranking official in DOT.

I agree with Boyd's assessment of the need for a centralized negotiating unit headed by an official of adequate rank. DOT may, or may not be the appropriate agency to house this unit. Obviously this issue is related to our continuing study of mechanisms to formulate international economic policy in general. I would recommend further analysis of the potential responsibilities of State, CAB, and STR in international air negotiations, and presentation of a formal decision memo from DOT for your review.

Electrostatic Copy Made
for Preservation Purposes

August 9, 1977

To: The President

From: Alan S. Boyd *ASB*

Re: Organization for International Civil Aviation Negotiations

Civil Aviation negotiations involve primarily economic issues: adequate service to the public, reasonable fares, and viable carriers. Environmental and political issues occasionally come into play.

Department of State, in its role of conducting U. S. foreign affairs, normally chairs U. S. delegations. For the past fifteen years negotiations have been generally conducted by its Office of Aviation with support from the Civil Aeronautics Board, Commerce Department, Department of Transportation (ten years) and occasionally Department of Defense, plus White House staff.

The Office of Aviation is headed and staffed by relatively low ranking Foreign Service officers. They do not have status or authority to direct studies or analyses for development of objectives or strategy. The Office has no analytical capability. The nominal chairman of a delegation is often outranked by representatives of other interested agencies.

For coordination, an Interagency Committee on International Aviation Policy exists. Chairman is U/S State for Economic Affairs. Its purpose is to develop or approve negotiating objectives and strategy. Its activities are perfunctory; its value is questionable.

The United States obtained enormous traffic rights in bilateral agreements negotiated immediately after World War II. Until the United Kingdom terminated its agreement in 1976, basic U. S. policy had been to avoid restrictions to the extent possible. The policy has been one of reaction.

This is no longer sufficient; the United Kingdom termination represents a turning point. A number of nations share the U.K. view that existing agreements are inequitable. United States flag carriers have been subjected to considerable harassment by nations who have not felt strong enough to confront the United States as the United Kingdom did. This practice may be expected to escalate in the future with the possibility of more terminations of agreement.

The existing United States government structure is inadequate. The Inter-agency Policy Group approves positions to be taken. Those positions are developed by individual agencies on the basis of dominant personality or doctrine related in part to how the particular agency perceives its role in civil aviation.

The CAB International Aviation Staff is weak and parochial; it tends to ignore political aspects of international civil aviation. The DOT Staff has a couple of outstanding people, but no depth. State's Office of Aviation has no analytical support.

A case can be made for assigning primary negotiating responsibility to any one of these agencies. My recommendation is that DOT be assigned to the task of handling and coordinating negotiations. DOT should develop a system approach to international civil aviation with aims and objectives stated. It should develop strategy for negotiations and coordinate with all interested agencies. DOT should establish a competent staff headed by an official of sufficient stature to assure the performance of tasks by other interested agencies.

CAB should be directed to provide statistical data and technical advice. State Department should be represented at all stages because of political implications, possibly through assignment of Foreign Service Officers to DOT.

A positive approach is needed to support our civil aviation interests abroad. It will not be done by a committee.

THE WHITE HOUSE
WASHINGTON
August 15, 1977

Hugh Carter

The attached was returned in
the President's outbox and is
forwarded to you for your informa-
tion.

Rick Hutcheson

WEEKLY MAIL REPORT

THE PRESIDENT HAS SEEN:

THE WHITE HOUSE

WASHINGTON

Week Ending 8/12/77

Q
/

MEMORANDUM FOR THE PRESIDENT

FROM: HUGH CARTER *HC*
SUBJECT: Weekly Mail Report (Per Your Request)

Below are statistics on Presidential and First Family:

<u>INCOMING</u>	<u>WEEK ENDING 8/5</u>	<u>WEEK ENDING 8/12</u>
Presidential	29,300	62,120 (a)
First Lady	1,330	1,370
Amy	410	440
<u>Other First Family</u>	<u>65</u>	<u>80</u>
TOTAL	31,105	64,010

BACKLOG

Presidential	6,230	10,730
First Lady	330	290
Amy	0	440
<u>Other</u>	<u>0</u>	<u>0</u>
TOTAL	6,560	11,460

DISTRIBUTION OF PRESIDENTIAL MAIL ANALYZED

Agency Referrals	51%	56%
WH Correspondence	21%	14%
Direct File	14%	22%
White House Staff	11%	6%
<u>Other</u>	<u>3%</u>	<u>2%</u>
TOTAL	100%	100%

NOT INCLUDED ABOVE

Form Letters and Post Cards	10,675	13,245
Mail Addressed to WH Staff	16,115	14,250

(a) Includes 25,851 foreign letters from Taiwan (write-in campaign). Will advise after review by Department of State.
cc: Senior Staff

Electrostatic Copy Made
for Preservation Purposes

MAJOR ISSUES IN
CURRENT PRESIDENTIAL ADULT MAIL
Week Ending 8/12/77

ISSUES	PRO	CON	COMMENT ONLY	NUMBER OF LETTERS
Pres.'s Position re: Federal Funds for Abortions	34%	66%	0	1,036
Suggestions re: Tax Reform Package (1)	0	0	100%	591
Support for Raising the Retirement Age for Social Security Recipients	0	97%	3%	549
Support for Amnesty for Illegal Aliens	2%	98%	0	406
Decriminalization of Marijuana (2)	26%	74%	0	388
Establish Separate Cabinet Level Department of Education	100%	0	0	351
Views/Suggestions re: Energy (3)	0	0	100%	272
Pres.'s Position re: Israel Returning Land Won In '67 War	18%	80%	2%	232
Support for Gun Control-HR 8128	1%	99%	0	187
Pres.'s Proposal re: Welfare Reform (4)	48%	26%	26%	165
Support for U.S. Retention of of Panama Canal (5)	87%	13%	0	150
TOTAL				4,327

(See Notes Attached)

NOTES TO MAJOR ISSUE TALLY

(1) SUGGESTIONS FOR THE TAX REFORM PACKAGE

Out of 591 letters, 256 writers urge retention of capital gains taxes. The letters are written by people associated with timber growing and harvesting.

(2) DECRIMINALIZATION OF MARIJUANA

The "con" mail (74%) is in part from people who have confused decriminalization with legalization, and from others who contend the decision is morally wrong.

(3) VIEWS AND SUGGESTIONS REGARDING ENERGY

Frequent points include:

- people do not believe there is a crisis
- people try to conserve, but their only reward is higher utility rates
- gas tax would hurt poor and rural residents
- do not tax gas, ration it
- if there is gas tax, money should go for research and development of energy sources, not mass transit
- stores should close on Sundays
- government should curtail misuse of energy (e.g., government cars wait for passengers with engines and air conditioning running)

(4) PRESIDENT'S PROPOSAL REGARDING WELFARE REFORM

Of the "pro" (48%), many are enthusiastic about work incentives in the plan and say reform is long overdue.

Of the "con" (26%) and "comment" (26%), there are those who say they want a more specific explanation of the plan, and some who claim the proposal would not save the taxpayers any money.

(5) SUPPORT FOR U.S. RETENTION OF THE PANAMA CANAL

The 150 letters received on this subject represent initial reaction, since announcement of the treaties was made midweek.

THE WHITE HOUSE
WASHINGTON

	FOR STAFFING
	FOR INFORMATION
X	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

ACTION
FYI

*5th - pl convey Pres's comments
to Treas + DoC as appropriate*

	MONDALE
	COSTANZA
X	EIZENSTAT
	JORDAN
	LIPSHUTZ
	MOORE
	POWELL
X	WATSON
X	LANCE
X	SCHULTZE

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER

Comments due to
Carp/Huron within
48 hours; due to
Staff Secretary
next day

	ARAGON
	BOURNE
	BRZEZINSKI
	BUTLER
	CARP
	H. CARTER
	CLOUGH
	FALLOWS
	FIRST LADY
	HARDEN
	HUTCHESON
	JAGODA
	KING

	KRAFT
	LINDER
	MITCHELL
	MOE
	PETERSON
	PETTIGREW
	POSTON
	PRESS
	SCHLESINGER
	SCHNEIDERS
	STRAUSS
	VOORDE
	WARREN

THE WHITE HOUSE
WASHINGTON

August 15, 1977

Stu Eizenstat

The attached was returned in the President's outbox and is forwarded to you for appropriate handling. Please convey the President's comments to the Departments of Treasury and Commerce as appropriate.

Rick Hutcheson

cc: Jack Watson
Bert Lance
Charlie Schultze

RE: TRADE DEFICIT

THE WHITE HOUSE
WASHINGTON

Mr. President:

No comment from CEA. (This
memo was revised to incorporate
comments from OMB and CEA on
an earlier draft.)

Rick

**Electrostatic Copy Made
for Preservation Purposes**

THE PRESIDENT HAS SEEN.
THE WHITE HOUSE
WASHINGTON

August 12, 1977

C

MEMORANDUM FOR:

THE PRESIDENT

FROM:

STU EIZENSTAT
BOB GINSBURG

Stu

SUBJECT:

The Trade Deficit
(At Your Request)

This memorandum summarizes the accompanying papers on the trade deficit prepared by Treasury and Commerce.

DIMENSIONS OF THE TRADE DEFICIT

1. Size. The trade deficit is expected to be about \$27 billion in 1977, an \$18 billion deterioration from the \$9 billion deficit for 1976. Imports are projected at approximately \$149 billion, with oil accounting for 30% of the total, and exports at \$122 billion.

2. Trade Account and Current Account. The current account balance includes the merchandise, agricultural products, and raw materials of the trade account as well as "invisible" items such as tourism, freight and transportation, investment income, and unilateral transfer payments; it measures a country's net balance in international transactions in goods, services, investment income, and transfer payments. Invisibles are projected to be in surplus by about \$11 1/2 billion in 1977 (\$8 billion in 1976). Accordingly, the current account should be in deficit by about \$15 1/2 billion (\$27 billion trade deficit less \$11 1/2 billion invisibles surplus) in 1977 (\$1 billion deficit in 1976).

Although less inclusive, the trade account is often given greater popular and political attention than the current account because in measuring the export and import of tangible products it is viewed by some as a better guide to the net impact of international trade on U.S. jobs. (That view is somewhat overdrawn because: (i) there is considerable labor content in such invisible items as tourism, freight, and banking and insurance services; (ii) there is relatively limited labor content in U.S. agricultural products, which account for roughly 20% of our exports; and (iii) about 50% of our imports are themselves necessary inputs for the production of goods in the U.S.)

3. Geographical Distribution. All the projected 1977 trade deficit can be accounted for by deficits the U.S. will be running with OPEC countries. The U.S. will be in rough balance with the non-OPEC world as a whole. However, the deterioration in the U.S. trade balance between 1976 and 1977 is accounted for partly by a deficit in our trade balance with Mexico and Brazil, our fourth and tenth largest export markets (we normally run surpluses with these countries but they are currently embarked on domestic stabilization policies), and a somewhat larger than usual deficit with Hong Kong, Korea, Taiwan, Japan and Canada (we normally run trade deficits with all these countries).

4. Product Distribution. The U.S. will run a \$40 billion deficit (\$45 billion in imports, \$5 billion in exports) in fuels (oil, gas, coal, nuclear fuel) in 1977 (\$32 billion deficit in 1976) and a surplus of approximately \$13 billion in all other products. In assessing the \$18 billion deterioration in our trade account between 1976 and 1977 on a product by product basis, the \$8 billion increase in fuels accounts for over 40% of the total and a decline in our surplus in manufactured goods from about \$19 billion in 1976 to \$13 billion in 1977 accounts for another 1/3.

5. Lag in Exports. While imports were up 26% in 1976 and are expected to increase by another 20% this year, exports increased only 7% in 1976 and are expected to increase only about 6% in 1977. Since these changes include price increases, the real volume of U.S. exports will be essentially flat for 1976 and 1977. Treasury attributes the imbalance between imports and exports basically to the oil situation and slower rates of economic growth abroad than in the U.S. Commerce is concerned that the lag in exports may also reflect some decline in international competitiveness of U.S. goods.

6. Prospects for the Future. The 1978 trade deficit is expected to be as large or larger than that for 1977. Although long-term projections must be considered with caution, Commerce expects a substantial trade imbalance to continue at least through 1980.

CAUSES OF THE TRADE DEFICIT

1. Oil. Fuel imports, up almost \$17 billion since 1975, are the most important factor in the trade deficit. The oil export revenues of the OPEC countries as a group are so huge that, even with large percentage increases in imports, they are running current account surpluses in the range of \$40-\$45 billion.

In a global context in which the oil-importing countries as a group must run deficits to absorb the \$40-\$45 billion OPEC surplus, the U.S. movement from current account surplus in 1975 to rough balance in 1976 to a \$15 1/2 billion deficit in 1977 has been "appropriate" -- without that movement, the financially weaker countries (both developed and LDCs) might be running unsustainable deficits which could be handled only by sharp and destabilizing changes in their domestic economic policies. However, of the financially stronger countries (U.S., Japan, West Germany, Switzerland, and The Netherlands), only the U.S. is doing its part in assisting adjustment to the international consequences of the OPEC surplus. (To be sure, some of our "strong" allies might argue that we are not doing our part where it counts most -- cutting back substantially on imported oil.)

The slow growth and current account surpluses in West Germany, Switzerland, and The Netherlands are particularly damaging to the "weak" countries of Scandinavia, France, the U.K., and Southern Europe. Only expanding markets in all the strong countries will allow the world economy to achieve a steady, sustainable growth path.

2. Favorable Economic Growth in the U.S. and Slow Growth Abroad. More than 1/2 of the \$18 billion deterioration in our trade balance between 1976 and 1977 is accounted for by non-oil trade (e.g., the \$6 billion decline in our surplus in manufactured goods). This is a function primarily of the relatively strong U.S. economic recovery, which has led to substantial increases in imports, and relatively slow growth abroad, which has constrained our exports.

The impact of differential growth rates on our trade balance is heightened by the fact that U.S. imports respond more sharply to changes in U.S. income than our exports respond to changes in foreign income, i.e., a 1% increase in U.S. income will lead to a 1.5 - 2.0% increase in our imports while a 1% increase in foreign income will only lead to a 1.0 - 1.5% increase in U.S. exports. (This is because (i) the U.S. imports a large amount of consumer goods, which are more heavily dependent upon changes in income than the agricultural products and capital goods which we export and (ii) imports constitute a smaller share of our consumption pattern than they do for our trading partners and, accordingly, are more flexible upward.)

It is not only West Germany and Japan that are growing slowly but virtually all of Europe and a number of non-oil LDCs. Some of the "weak" countries of Europe and the non-oil LDCs are embarked on domestic stabilization policies to reduce their debt and get

their economies in balance and also have to pay an increasing part of their foreign exchange for oil. U.S. exports to non-oil LDCs, even in inflated dollars, have been virtually flat for the past two years.

3. U.S. Competitiveness. Any judgments about changes in competitiveness over relatively short time periods must be inherently conjectural because the conclusions reached will depend crucially on the base period chosen. Commerce points out that the export prices of U.S. manufactured goods increased relative to those of our trading partners during the period between mid-1974 and early 1976. With a 1-2 year normal lag in the impact of changes in relative prices on manufacturing exports, this "decline" in "competitiveness" may presently be having some adverse effect on manufacturing exports and may continue to do so for the next year or so.

However, Treasury points out that since early 1976 U.S. inflation has been lower than the average inflation rates experienced by our major trading partners and, therefore, in terms of relative prices the U.S. has probably made some small gains in "competitiveness" recently. Commerce also notes that most foreign governments do considerably more to promote and even subsidize exports than does the U.S.

The U.S. share of world manufacturing exports was 20.3% in 1976, down from 21.2% in the cyclically high year of 1975 but up from the 19.1% historic low point of 1972.

IMPLICATIONS OF THE TRADE DEFICIT

1. Economic Implications. Lagging exports have an obvious adverse effect on economic growth, jobs, and Federal tax revenues. To the extent that the sharp increase in imports (at a time when U.S. unemployment and excess capacity are high) is due to unfair competition from abroad, U.S. industry is being hurt and domestic production impaired. Beyond these truisms, there is general agreement that it is appropriate international economic policy for the U.S. to be running a current account deficit at this time. The questions relate to the causes, size, and persistence of the deficit and our ability to sustain it over time, if necessary, without adverse economic or political fallout.

Commerce believes that "persistent, excessive" U.S. trade deficits would tend to create uncertainty and instability in the world and U.S. economies, with attendant political risks.

Treasury notes that the ratio of the present current account deficit to U.S. GNP is about the same as that for the OECD as a whole (about 1% in each case) and that the U.S., with its strong economy and capital markets and stable political system, is better able to finance and manage a deficit than almost all other countries. Treasury believes that our focus should be on reducing the oil problem and urging the other "strong" countries to expand their economies, that the U.S. competitive position remains strong, and that the U.S. should not take measures which would attempt to improve our trade balance at the expense of our trading partners.

2. Political-Psychological Implications. To some, a trade deficit and a depreciating dollar are inherent signs of weakness. To others, they are potent arguments for import restraints (which, in turn, could severely jeopardize our efforts to control inflation). Although these views may have to be met in the political arena with public education, they are without economic merit. Short run "fixes" for the trade deficit (e.g., import restrictions or slowing down economic growth through monetary and fiscal policy or through import quotas on oil) would be worse than the problem itself.

POSSIBLE RESPONSES TO THE TRADE DEFICIT

1. Short Run. There is little we can do which will substantially reduce the trade deficit over the next year or two. Those policies which would work -- such as import restrictions or cutting back on domestic economic growth -- are inherently undesirable.

2. Recommendations. Treasury and Commerce are in basic agreement on the following set of responses to the trade deficit:

- (a) an energy program which will reduce oil imports; *good*
- (b) encouraging the "strong" countries (Japan, West Germany, Switzerland, and The Netherlands) to expand their economies, thereby increasing their imports; *good*
- (c) encouraging the "strong" countries to allow their exchange rates to rise, thereby reducing the price competitiveness of their exports (that kind of automatic adjustment is a basic purpose of floating exchange rates but it can be thwarted by government intervention in the exchange markets); *good*

- (d) acting against specific cases of dumping or unfair foreign trade practices; *good*
- (e) increasing official IMF resources to enable other countries to adjust to their oil problems at reasonable paces without forcing destabilizing cutbacks in their domestic economic policies; *good*
- (f) pursuing the reduction of barriers to U.S. exports in the MTN and in direct consultation with countries like Japan; *good*
- (g) increasing the export awareness of U.S. producers and increasing the promotion of U.S. exports; *good*
- (h) adequate export financing (Commerce supports an expansion of the Export-Import Bank and DISC; ~~no~~ Treasury, believing that U.S. goods have not lost their competitiveness and that export subsidization would both undermine our efforts to reduce these practices by others and provoke retaliation, would not go as far in expanding the ExIm Bank and thinks DISC contributes virtually nothing and should be eliminated); and *I agree*
- (i) educating the U.S. public on the problem in order to reduce the possibility of ill-advised political reactions. *good*

3. Additional Responses. Although not mentioned in the Treasury or Commerce papers, we would add the following to the list of possible responses:

- (a) If the trade deficit persists and you determine that more vigorous action needs to be taken, you should seek advice from Secretary Vance and Dr. Brzezinski on possible diplomatic/political responses to encourage more equitable policies by the "strong" countries. The Treasury and Commerce papers are concerned mainly with economic responses. We know that we are pushing Japan and West Germany fairly hard already and would not recommend any additional pressure for now, but there may come a time when we need to take a broader look at our options for dealing with the underlying problem of unbalanced economic policies among our allies (probably less for reasons of our own trade deficit than to protect the stability of the "weak" countries of Europe).

- (b) The IMF will meet in Washington in late September. All of the leading finance ministers, private bankers, etc. will be here. Normally the President makes brief, non-substantive welcoming remarks. You might use the occasion for a major substantive speech on international economic policy, describing the contribution the U.S. has made to world economic stability in the past few years and indicating that it is time for more equitable sharing of the burden of the oil deficit by all the strong economies.

The speech could have the positive international consequences of (i) putting all nations squarely on notice that the U.S. should not be expected to absorb the oil deficit alone and (ii) actually galvanizing our strong allies to adopt more equitable economic policies. It could also have the major domestic benefits of educating the American people and getting out in front in a leadership role on this issue.

TREASURY

COMMERCE

FOR OFFICIAL USE ONLY

THE U.S. TRADE DEFICIT

- **DIMENSIONS**
- **CAUSES**
- **IMPLICATIONS**
- **POSSIBLE RESPONSES**



U.S. DEPARTMENT OF COMMERCE
Domestic and International
Business Administration

July 8, 1977

FOR OFFICIAL USE ONLY

CONTENTS

	Page
I. Dimensions of the Deficit	1
II. Causes of the Deficit	4
III. Trade Balance Outlook	17
IV. Implications of the Deficit	24
V. Conclusions	28
VI. Options in Response to the Deficit	29

U.S. trade has been in deficit at an annual rate of \$23 billion so far this year. There seem to be no factors which will significantly alter this deficit position during the remainder of 1977, and Departmental forecasts are presently indicating a full-year deficit of \$20-25 billion.

If this outlook is correct, the U.S. will experience a trade deficit three times the previous record level (1972). The trade deficit, moreover, has become large enough to more than offset a continued surplus in services transactions, putting the U.S. current account (all goods and services transactions) in deficit at an annual rate of \$17 billion in the first quarter. The current account is the basic financial measure of foreign earnings and expenditures and is widely-watched as an indicator of a nation's need for foreign capital, exchange rate changes, or other adjustments.

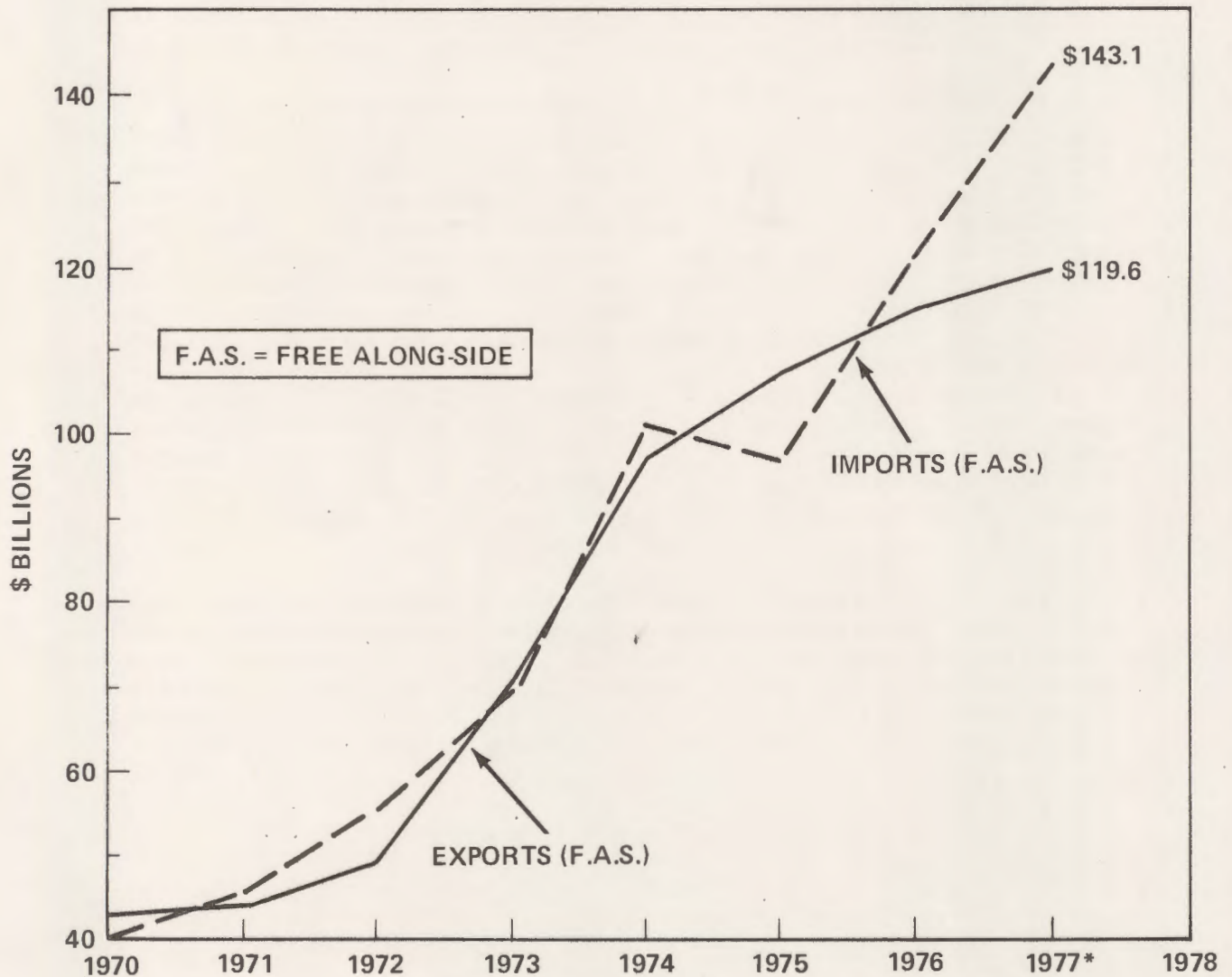
As shown in Figure 1, the growth in the trade deficit has not been the result of a sudden shift in trade this year alone. The trade balance has been declining since 1973, with the exception of the highly-unusual year of 1975. The anticipated 1977 trade deficit will be around \$20 billion larger than the \$2 billion deficit of 1974.

Oil imports have been the key problem, as illustrated in Figure 2. Non-oil trade, however, has become a serious problem as well. The U.S. non-petroleum trade balance improved sharply in 1975, principally due to cyclical factors. The non-petroleum trade balance, however, fell \$10 billion in 1976 -- and will fall almost as much in 1977, putting the non-oil trade balance below the level of 1974.

NOTE: All merchandise trade data in this paper are on the Census basis, which is the only means by which detailed product and country trade data are available. Some other discussions of trade may use the "balance of payments" basis, which differs slightly in magnitude.

FIGURE 1

U.S. IMPORT GROWTH CONTINUES TO EXCEED EXPORT GROWTH IN 1977



● 1977 EXPORTS INCREASING AT 8%, BUT IMPORTS UP 29%. (JAN-MAY 1977 VS. JAN-MAY 1976)

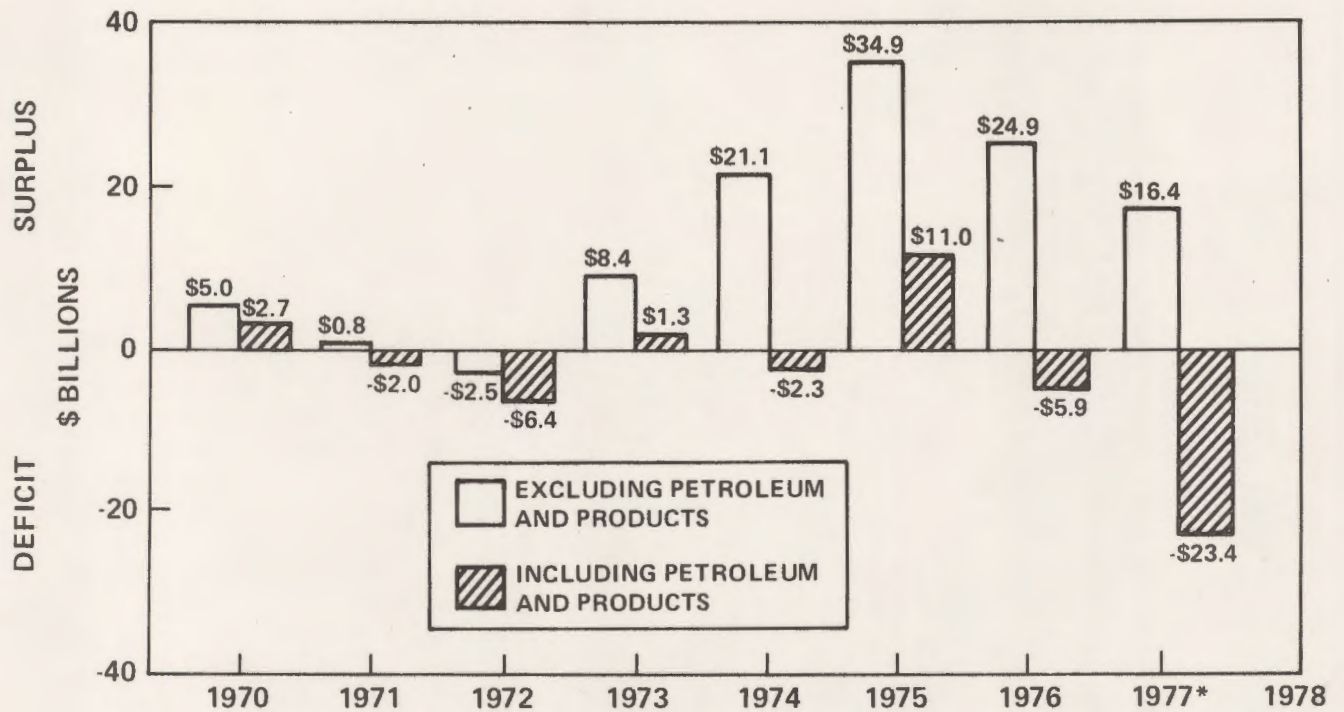
● TRADE DEFICIT THRU MAY AT ANNUAL RATE OF \$23.4 BILLION

● 1976 DEFICIT WAS \$5.9 BILLION AND 1975 TRADE WAS IN SURPLUS BY \$11.0 BILLION

* 1977 DATA ARE JAN-MAY SEASONALLY ADJUSTED AT AN ANNUAL RATE

FIGURE 2

TRADE BALANCE: THE IMPORTANCE OF PETROLEUM



- TRADE SURPLUS IN PRODUCTS OTHER THAN PETROLEUM CONTINUES TO DECLINE IN 1977
- THIS SURPLUS IS DECLINING AT AN \$8 BILLION ANNUAL RATE WHILE THE DEFICIT IN PETROLEUM IS EXPANDING AT A RATE OF \$9 BILLION

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

This year will mark the second straight year of rapid U.S. import growth and slow export growth. As shown in Figure 3, U.S. exports in the first five months of 1977 have increased only 8 percent over the year-ago period, while imports are up almost 30 percent. As a result, the 1977 trade deficit to date is nearly \$18 billion larger than in 1976, at an annual rate.

Oil imports are the single most important cause of this dramatic decline, but this is only half the story. Nearly half of the decline in the trade balance is in non-petroleum trade, the bulk of which is accounted for by a \$6 billion decline in the manufactured goods trade balance.

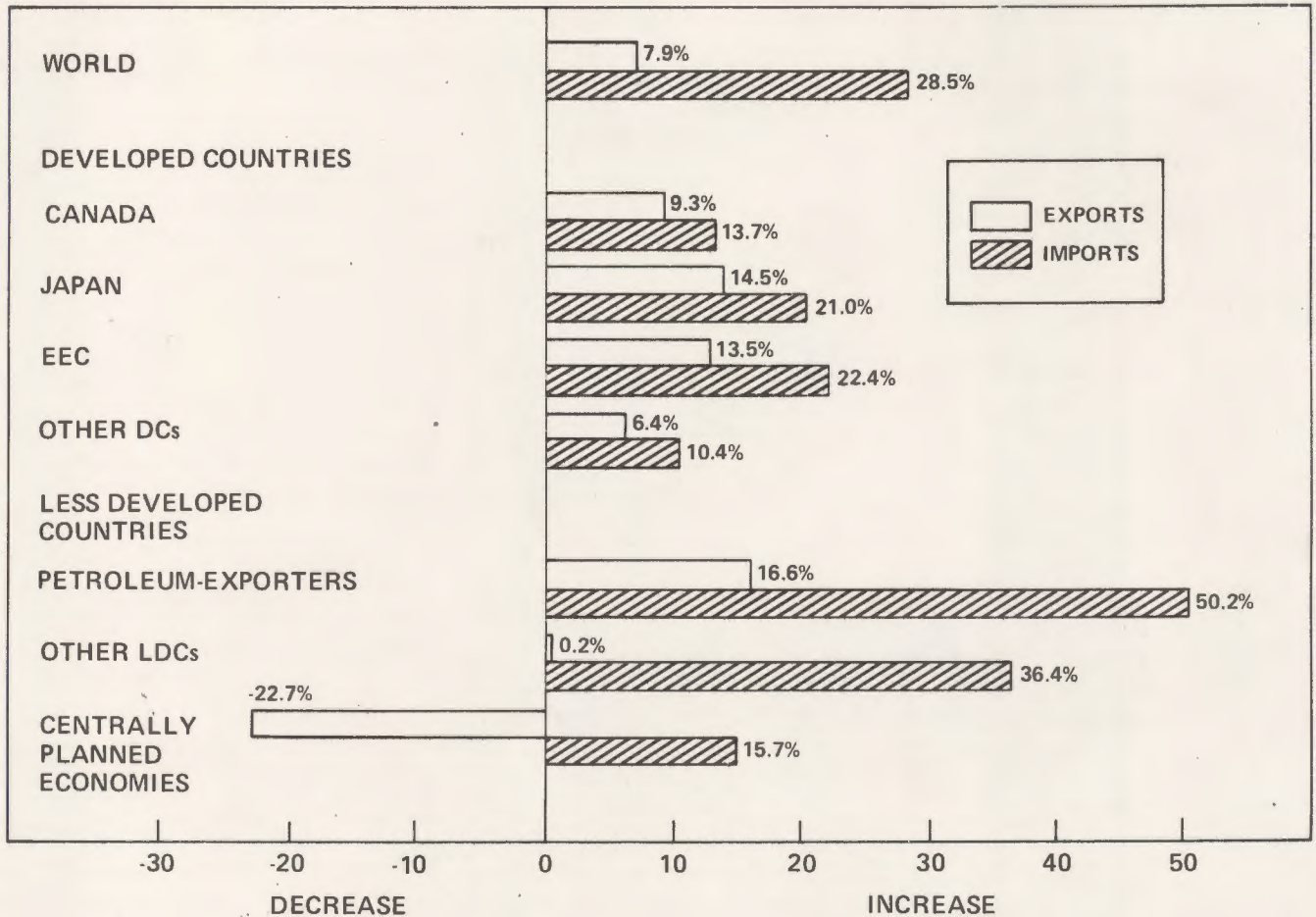
The decline in non-petroleum trade was widespread. As shown in Figure 4, the balance declined in all major product categories. Regionally, the bulk of the decline in the non-petroleum balance was with the non-oil producing LDCs (Figure 5) -- representing the continuation of what has now been the case for several years.

Many Causes -- Many causes lie behind the growth in the trade deficit, and their inter-relationship is complex. Next to oil, faster economic growth in the United States than abroad is the principal reason for the increasing deficit -- but this is too simplistic an explanation. The important thing to understand is why economic growth abroad and demand for U.S. exports are growing slowly.

It is particularly important to consider whether these factors are temporary, or whether they are more enduring. It is a mistake to assume that most of the factors that have increased the U.S. deficit are cyclical -- and that the U.S. trade deficit will quickly diminish once economic recovery catches hold abroad. While some of the causes of our large deficit do appear temporary, many of them give disquieting signs of being more structural or enduring.

FIGURE 3

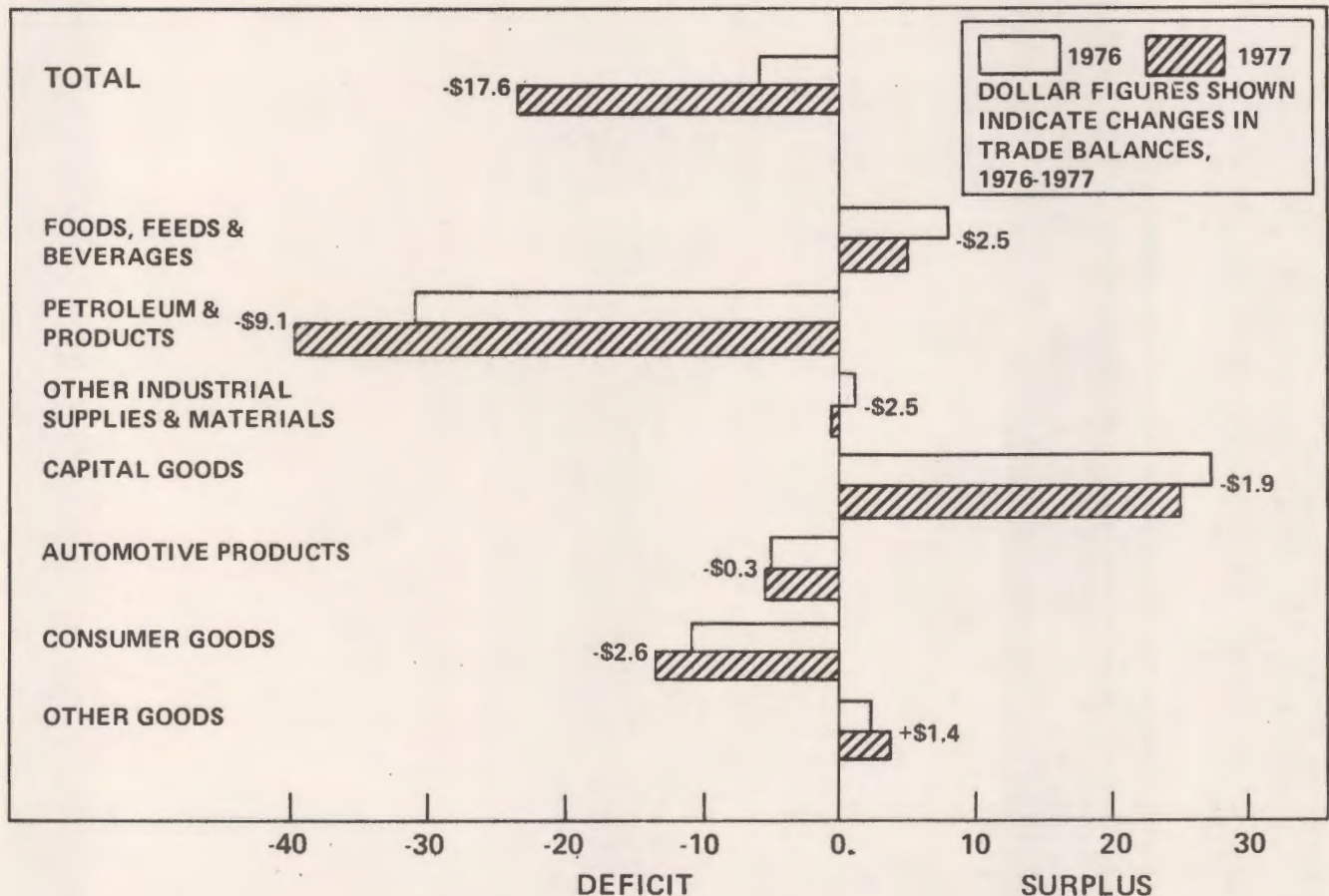
1977 GROWTH IN U.S. EXPORTS AND IMPORTS BY REGION
(FIRST FIVE MONTHS OF 1977 VS. FIRST FIVE MONTHS
OF 1976, PERCENTAGE CHANGE)



- FASTEST U.S. IMPORT GROWTH FROM:
 PETROLEUM EXPORTERS
 EEC
 JAPAN AND NON-OIL LDCs – CONSUMER PRODUCTS
- FASTEST U.S. EXPORT GROWTH TO:
 PETROLEUM-EXPORTERS
 EEC AND JAPAN
- NO GROWTH IN U.S. EXPORTS TO NON-OIL LDCs FOR SECOND CONSECUTIVE YEAR

FIGURE 4

1977 TRADE BALANCE DECLINES IN ALL MAJOR PRODUCT CATEGORIES . . . (\$ BILLIONS)

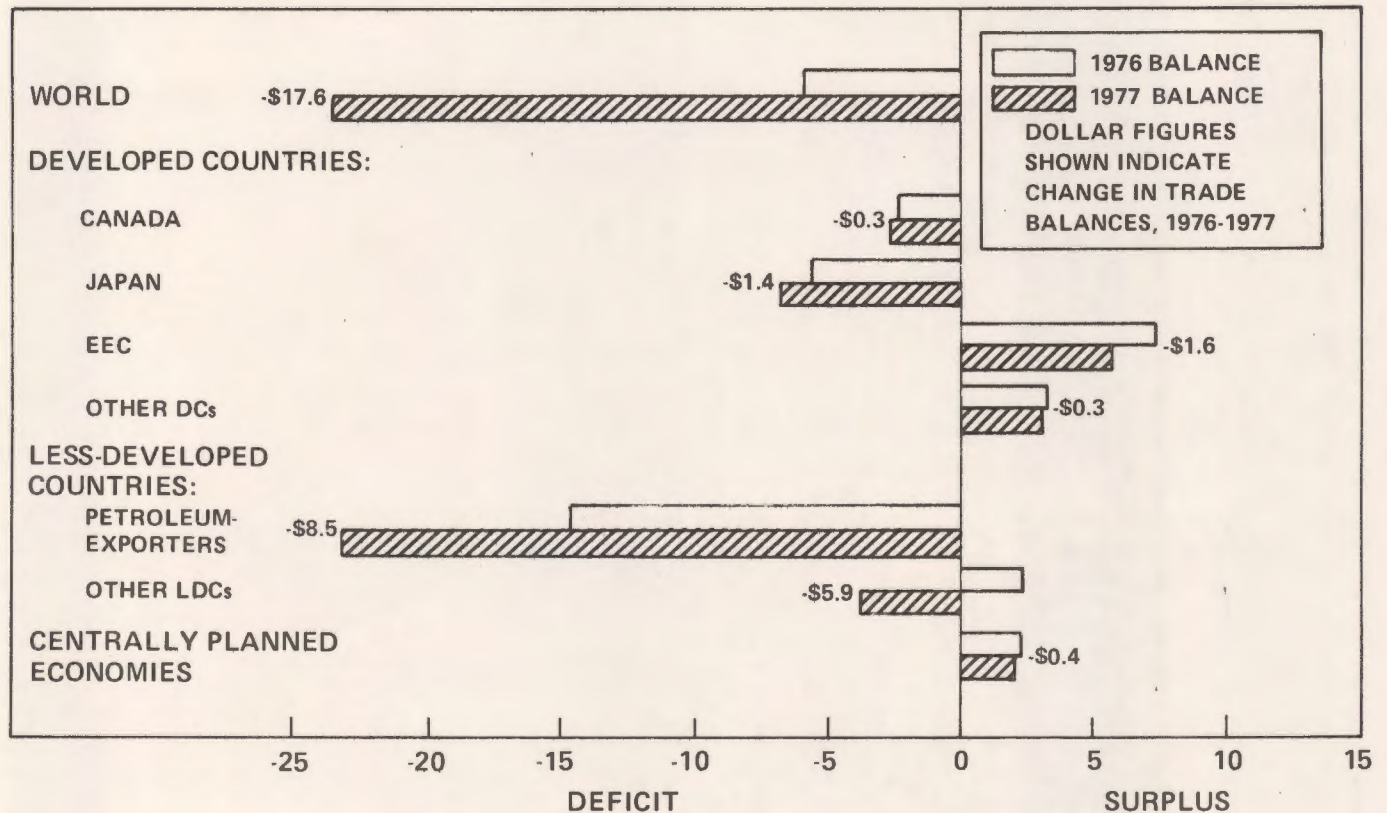


- OVER ONE HALF OF DETERIORATION IN PETROLEUM; BUT LOSS IN OTHER PRODUCTS ALSO SIGNIFICANT
- FASTEST IMPORT GROWTH IN FOODS, FEEDS & BEVERAGES(44%) AND PETROLEUM(48%)
- SLOW EXPORT GROWTH (3%) IN IMPORTANT CAPITAL GOODS CATEGORY (JAN-MAY 1977 VS. JAN-MAY 1976)

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATES

FIGURE 5

... AS WELL AS WITH ALL REGIONS
(\$ BILLIONS)



- LARGEST TRADE BALANCE DECLINES WITH PETROLEUM-EXPORTERS, NON-OIL LDCs, EEC AND JAPAN
- FIRST U.S. DEFICIT (\$3.6 BILLION) WITH NON-OIL LDCs THIS DECADE

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

The major causes of the 1977 deficit can be identified as:

- Continued oil import growth
- Favorable U.S. economic growth
- Slow economic growth in other industrial nations
- Composition of U.S. trade
- Financial constraints on LDCs
- OPEC import absorption constraints
- A changed world agricultural situation
- U.S. manufactured goods competitiveness decline

Separating out the short-term and long-term components of many of these factors is difficult, and quantifying the separate contribution of each of these inter-related factors is nearly impossible. At the most basic level, for example, higher oil prices are the major underlying cause of slow world-wide growth, changes in currency values, and severe international disequilibria.

Oil Imports -- The \$9 billion annual rate of increase in the petroleum deficit so far this year reflects the unusually-severe winter. However, it also reflects continued reductions in U.S. oil production and continued increases in oil import prices. Alaskan oil is expected to slow the rate of oil import growth in late 1977 and in 1978, but Alaskan oil is not expected to be plentiful enough to cause the value of oil imports to decline.

Forecasts indicate that oil imports in 1978 should be about as large as in 1977, and that they will again begin growing in 1979. The United States is the world's largest oil importer, and oil imports will remain the key cause of the nation's trade difficulties.

Favorable U.S. Economic Growth -- The strong U.S. economic recovery has played an important role in the rapid growth of imports. Since the recession trough of 1975, the volume of imports has increased 48 percent though the first quarter of 1977, while industrial output has grown 18 percent (and real GNP some 12 percent). The faster

rate of recovery for imports is to be expected since fluctuations in import volumes historically have tended to exceed cyclical movements in the economy -- for example, real imports fell 21 percent in the recession while industrial output fell 14 percent and real GNP fell 6 percent.

Current levels of imports appear to be consistent with historical patterns. The volume of imports did not surpass pre-recession levels until mid-1976 and the ratio of imports to domestic activity (in real dollars) is only now achieving pre-recession levels.

The current volume of imports, particularly manufactures, suggests that ample opportunity for further strong import growth still exists. Consumer goods imports were strongly up in the first quarter of 1977, but relative to real consumer expenditures in the United States they are still below what might be expected based on pre-recession levels. Additionally, inventories of foreign cars in the United States were sharply drawn down by the recent increase in foreign car sales -- implying that auto imports can be expected to grow strongly later this year.

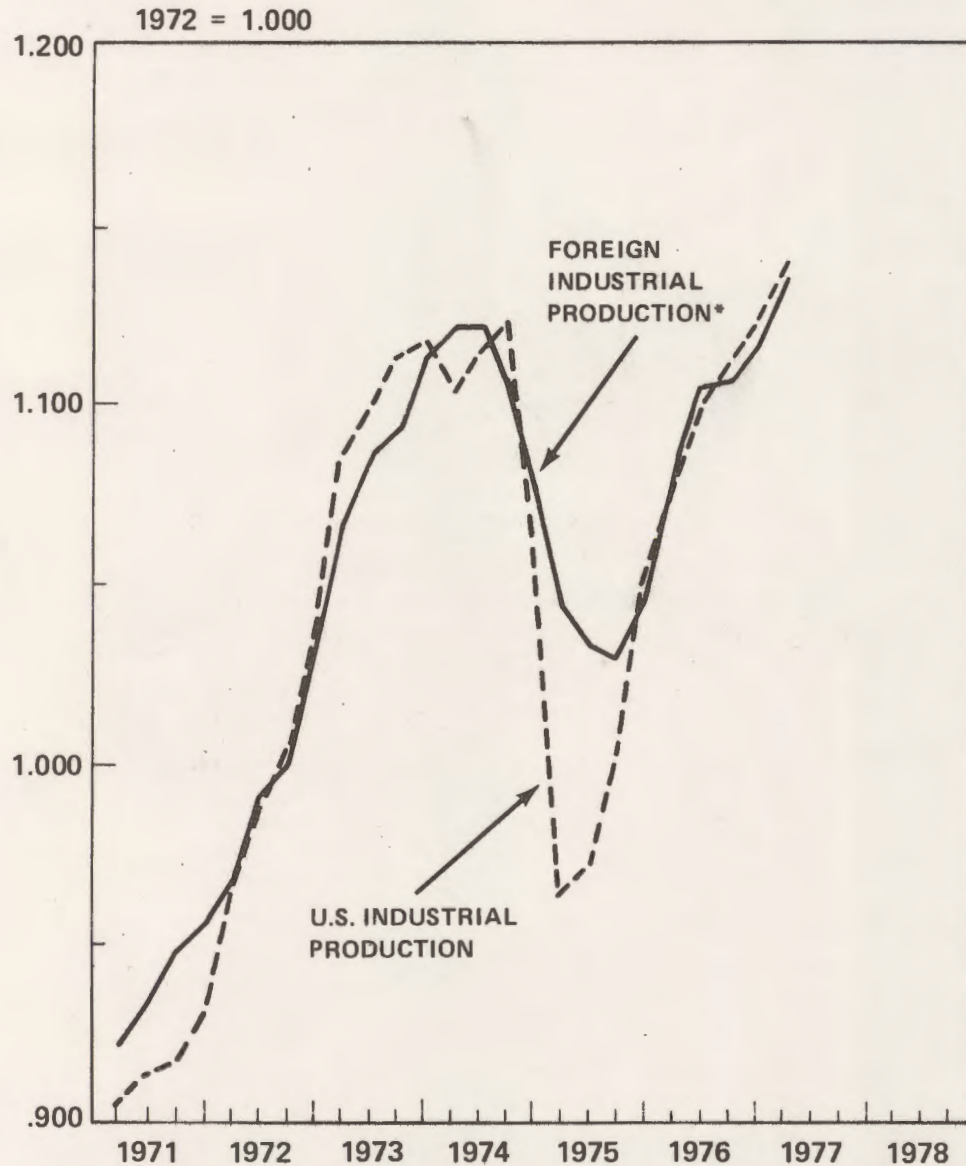
Continued U.S. economic growth, coupled with increasing import penetration, is expected to push up the volume (and value) of imports at a robust rate, particularly for the rest of 1977. Increases in 1978 will probably be more moderate, but still substantial.

Slower Economic Growth Abroad -- It has been popular of late to attribute a large proportion of the increase in the U.S. trade deficit to cyclical factors -- i.e., the divergence of business cycles between the United States and other industrial economies. Close observation shows, however, that cyclical factors do not appear to have been the major cause of the increase in the U.S. non-petroleum trade deficit so far in 1977.

As shown in Figures 6 and 7, cyclical factors were of extreme importance in 1975, when industrial production fell considerably more in the United States than in other industrial nations. This cyclical divergence led to a huge -- but very temporary -- U.S. trade surplus in 1975. In the first quarter of 1974, the U.S. trade surplus with developed nations was at an annual rate of \$3 billion. By the third quarter of 1975 that surplus had risen to an annual rate of over \$10 billion -- but by the first quarter of 1976 the U.S. surplus had returned to an annual rate of about \$3 billion.

FIGURE 6

U.S. RECESSION DEEPER BUT RECOVERY FASTER THAN FOREIGN ECONOMIES

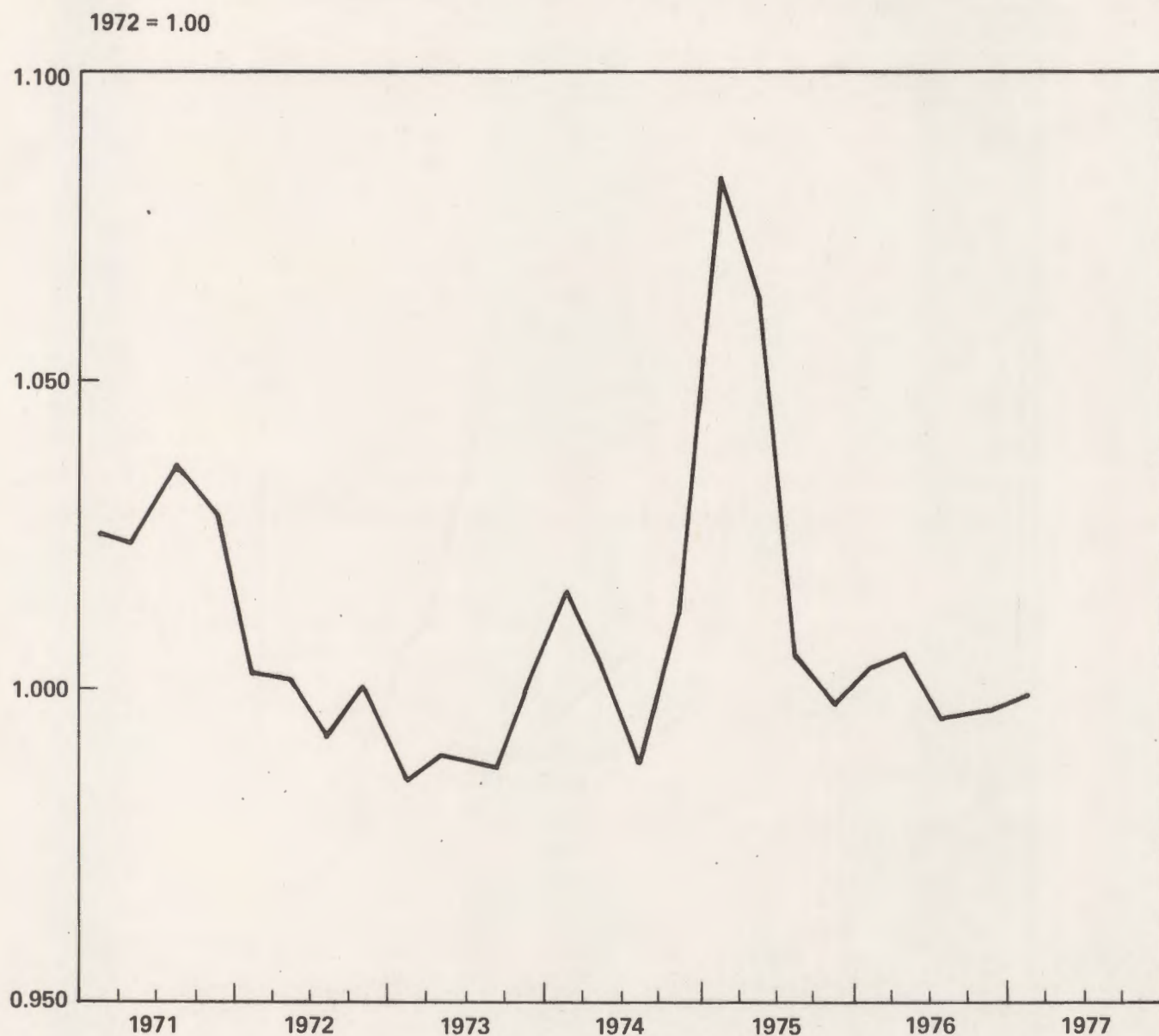


- U.S. PRODUCTION DECLINE LARGER THAN FOREIGN: 14% BELOW PREVIOUS PEAK VS. 8% FOR FOREIGN PRODUCTION
- BY 1977 BOTH U.S. AND FOREIGN PRODUCTION RECOVERIES ABOUT EQUAL: U.S. PRODUCTION WAS 1.3% ABOVE PRE-RECESSION PEAK AND FOREIGN PRODUCTION 1.2%

*CANADA, FRANCE, GERMANY, ITALY, JAPAN, AND UNITED KINGDOM

FIGURE 7

**CYCLICAL FACTORS CONTRIBUTED STRONGLY TO U.S. 1975
TRADE SURPLUS, BUT CYCLICAL FACTOR
RELATIVELY MILD SINCE THEN**



- RATIO OF FOREIGN INDUSTRIAL PRODUCTION TO U.S. INDUSTRIAL PRODUCTION INCREASED DRAMATICALLY IN 1975
- RATIO RETURNED TO PRE-RECESSION LEVELS BY 1976, NOT SHOWING SIGNIFICANT DOWNWARD PRESSURE ON TRADE BALANCE THRU 1977 I

Since early 1976, as may be seen in Figure 7, the cyclical divergence of production between the U.S. and the other industrial nations has been relatively mild. A slight downward trend in foreign production relative to U.S. production during 1976 has been discernible, but this movement does not appear sufficient to have been the major cause of the increase in the U.S. non-oil deficit in 1977.

Preliminary data through May 1977, however, indicate that a more pronounced cyclical divergence may in fact have begun to occur after February. A marked slowing of industrial production growth in other developed nations began in February, while U.S. production growth has accelerated from 1976.

Cyclical factors affect trade with a time lag of some months, and this new divergence of business cycles may reflect itself as a force tending to worsen the U.S. trade balance with the industrial economies around mid-1977 or so.

While we expect industrial production in the other developed nations to shortly return to about the growth trend of 1976, we do not see near-term factors which would cause a sharp improvement in the U.S. trade balance with the industrial nations. Forecasts through 1978 and 1979 do not presently offer much hope for faster economic growth in other industrial nations than in the United States.

A relatively slow growth path in other industrial nations is largely deliberate. Smaller industrial nations have had to curtail their growth because they have been unable to sustain the trade deficits they have been incurring. Germany and Japan, the keys to faster economic growth abroad, have been relying on export-led growth and continue to resist stimulation of their economies out of fears of re-triggering inflation.

Composition of U.S. Trade -- Economic growth since 1975 in the U.S. and the other industrial countries has been consumer-led (export-led, for Germany and Japan). Capital investment has been among the slowest-growing sectors of all industrial economies. Demand for consumer goods has therefore been growing considerably more rapidly than demand for capital goods.

This has tended to automatically increase the U.S. trade deficit, for the United States traditionally is an exporter of capital goods and an importer of consumer goods.

Exports of capital goods to the industrial nations so far in 1977 have grown 8 percent over the comparable period of 1976. While this is not an unfavorable rate compared to overall U.S. export growth, it has been substantially exceeded by imports of consumer goods from the developed nations, which are up 29 percent.

This factor can be expected to contribute to the trade deficit as long as the investment sector continues to grow slowly abroad. Given the large amount of excess capacity in most industrial countries, it would be imprudent to consider a reversal of this factor imminent.

Additionally, it must be noted that the LDCs, not the industrial countries, are principally responsible for the slow worldwide growth of U.S. capital goods. LDCs account for nearly half of U.S. capital goods exports, and our capital goods exports to them are lower so far in 1977 than they were a year ago.

Financial Constraints on LDCs -- The high oil prices that began in 1973 have placed most of the non-oil-exporting LDCs in a severe financial bind, and have diminished their ability to import products other than oil -- including imports from the United States.

Aid flows and private investment have not increased commensurately with the increased oil bills of these countries, and the non-oil LDCs have had to divert a higher proportion of their foreign exchange inflows to pay for oil imports. Their foreign exchange earnings, moreover, have been growing relatively slowly since 1974 because of the slow growth of industrial country markets for their goods.

Having borrowed as much as they could, many of the non-oil LDCs have had no choice other than to curtail their imports and their economic growth. In some instances a reduced rate of economic growth has been coupled with significant devaluations and with tightened import restrictions.

These conditions are an important reason why U.S. exports to the non-oil LDCs so far in 1977 are unchanged from a year ago -- making 1977 the second straight year of no U.S. export growth to the non-oil LDCs. U.S. exports to these countries, in fact, are now at a rate only 4 percent above the level of 1974. This has had a significant impact on U.S. exports, as the non-oil LDCs normally account for more than one-fifth of U.S. export growth.

OPEC Import Absorption Constraints -- Many of the OPEC nations have been unable to physically absorb all the imports ordered for their ambitious economic development plans following the oil price increase of 1973. These nations subsequently had to scale down their development targets to more realistic levels, and have reduced their import orders accordingly.

The scaling-back of orders has resulted in a slowdown in the rate of U.S. export growth to the OPEC nations. Huge OPEC orders and large increases in U.S. export prices had resulted in annual gains of up to 70 percent in U.S. exports to OPEC during 1973-75. U.S. export growth to OPEC slowed to a 16 percent increase in 1976 and has continued slowing through 1977.

While a comparison of the first five months of 1977 with the corresponding period of 1976 shows a 13 percent increase in exports to the oil countries, the average rate of growth has been decelerating during the last six months.

Changed World Agricultural Situation -- A changed world agricultural situation has slowed U.S. agricultural export growth and has spurred U.S. agricultural imports. As a result, the U.S. balance of trade in agricultural products has declined nearly \$2 billion in 1977.

The bulk of the movement has been on the import side -- principally due to the huge increase in the price of coffee. Coffee imports so far this year have been running at an annual rate of \$5 billion -- nearly \$3 billion higher than the rate of a year ago. The price of coffee peaked in April and is expected to abate somewhat during the next year, but a return to a more normal price situation is not expected before the end of 1978.

U.S. agricultural exports, on the other hand, have been showing considerably less growth than in recent years -- principally because of significantly improved grain harvests worldwide. Both the quantity and the price of U.S. grain exports have fallen, and agricultural exports so far this year have been propped up by large increases in soybean prices.

Unless weather conditions abroad result in poor crops, which is not the current expectation, U.S. agricultural exports in the next year or so should be expected to grow more along the moderate lines that prevailed prior to 1973.

U.S. Manufactured Goods Competitiveness -- The major factors determining competitiveness are relative prices and marketing efforts, and the U.S. appears to have lost some ground in both. An increase in U.S. manufactured prices relative to competitor's prices would be expected to reduce the U.S. share of world trade in manufactures.

All major indicators of price competitiveness (such as comparisons of wholesale prices for manufactures, unit value indexes, and export price indexes) show that dollar appreciation between mid-1974 and early 1976 caused U.S. manufactured goods to lose about half the price competitiveness gains they had obtained from the 1971 and 1973 devaluations of the dollar (see Figure 8).

Most economic studies have found that 1-2 years are required for changes in relative prices to significantly affect the volume of manufactured goods exports and export shares. Thus the effect of the mid-1974 to early 1976 losses in price competitiveness would be expected to affect the U.S. share of manufactured goods trade during approximately the period of mid-1975 to 1978.

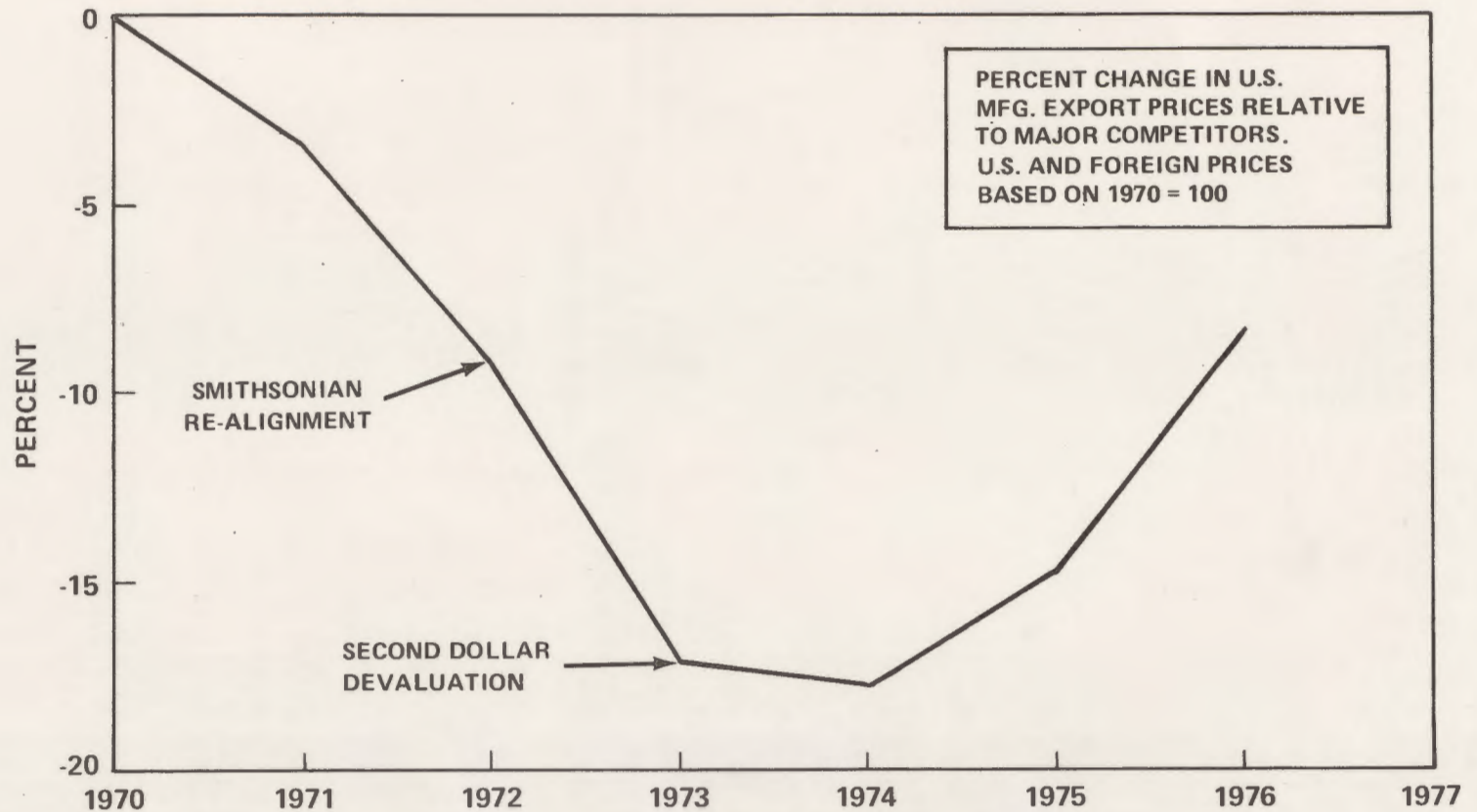
The actual behavior of the U.S. market share is consistent with this expectation. Apparently responding in part to the price effects of the 1971-73 devaluations, the U.S. share of manufactured goods trade reversed its long decline and began growing in 1972. It peaked at 21.9 percent in the third quarter of 1975 -- erasing almost all the share losses of the previous six years.

After peaking in the third quarter of 1975, however, the U.S. share began a new fall. It has fallen steadily for at least 18 months and stood at 20.0 percent in the fourth quarter of 1976.

Had the share not fallen from its peak, U.S. manufactured goods exports would have been at an annual rate \$7 billion higher in the fourth quarter of 1976 than they actually were. The actual loss due to competitiveness, however, is almost certainly considerably smaller than that. Non-price factors also affect market shares; in addition, some of the share loss must be attributed to the fact that many of the country and product markets of greater importance to the United States than to its competitors have been growing particularly slowly.

FIGURE 8

U.S. EXPORT PRICE COMPETITIVENESS IN MANUFACTURES DETERIORATING



- U.S. EXPORT PRICES FOR MANUFACTURES BEGIN RISING MORE RAPIDLY THAN FOREIGN MANUFACTURES PRICES IN 1975
- MUCH OF THE PRICE COMPETIVENESS GAINED FROM FEBRUARY 1973 DEVALUATION LOST

While the size and composition of the present trade and current account deficits are of concern, it is the duration and persistence of these deficits which is of the greatest significance. There are two perspectives that need to be considered; (1) the near-term expectations for the deficit; and (2) the longer-term prospects for the trade account.

PROSPECTS IN THE NEAR-TERM

We expect that the trade deficit during the remainder of 1977 should be somewhat more moderate than the first quarter level, which reflected the very high fuel imports caused by the severe winter. For the year as a whole, nevertheless, our forecasts presently indicate a deficit of \$20-25 billion.

Prospects for 1978 suggest that the large U.S. trade deficit will persist. Initial Departmental forecasts indicate a deficit in the range of \$21 to \$34 billion, depending upon U.S. and foreign economic growth and ignoring any compensating exchange rate adjustment that might take place. North Slope oil entering at more than 1 million barrels per day in 1978 will help to keep the volume of fuel imports at or just below 1977 levels, with the value increasing only slightly -- if at all.

Non-fuel imports, however, should continue to expand. In 1976 their volume, though up 20 percent over 1975, was only just above pre-recession 1973 levels; hence there is ample scope for continued expansion in imports, particularly of consumer and capital goods. The forecasts do, nevertheless, assume a slower rate of growth in the volume of non-oil imports than that experienced in 1977, due partially to slightly slower domestic economic growth and a leveling out of import penetration rates. If pre-recession trends in the growth of import penetration were renewed, however, imports could be considerably higher.

On the export side, the volume of exports has been stagnant since the large jump in 1975. Improved growth abroad would help some, but closing a deficit of \$20 billion even by one-half would require a

1978 increase in the value of exports more than double that now being forecast. Given the continued problems of the non-oil LDCs and the industrial nations -- as well as intensified competition around the world -- gains of such magnitude do not appear likely at this time.

These forecasts do not, as noted above, assume exchange rate changes to adjust for the deficit. If the dollar were to devalue, the immediate effects would be inflationary for the domestic economy with the beneficial trade effects taking perhaps one to two years to be felt.

CONSIDERATIONS FOR THE LONG-TERM

The factors which affect both exports and imports over the long-term are numerous, and the possible range of variance in these factors is broad. Thus, it is unrealistic to expect that long-term forecasts of the trade balance can be made with any significant degree of accuracy. It is possible, however, to assess the probable direction of change of some of the more important influences on U.S. trade over the next decade and their implications for the trade balance.

Major Import Determinants:

- The major determinant of U.S. import levels will be the level of domestic economic activity within the United States. The higher the growth rate in our economy, the higher will be our demand for foreign materials and products, both as inputs to our production and as consumer items to meet higher income levels.
- Also of major importance is the degree to which our reliance upon, and demand for, imported items changes over time. Changes in the proportion of imports to domestic activity will be influenced by myriad factors -- such as U.S./foreign relative productivity and price changes, changes in the structure of the U.S. economy, new consumer preferences, emerging manufacturing capabilities in the LDCs, and different degrees of international integration of production and cooperation.

- The level of U.S. oil imports is particularly important. This level will be determined by a number of factors, in particular: the growth in the economy, domestic energy production, energy conservation policies, and future energy prices. The possibility has been raised, moreover, of massive oil price increases occurring during the 1980's.

Virtually all the principal factors influencing U.S. import levels indicate strong expansion of import levels over the long-term. U.S. economic growth is expected to continue, the degree of integration of world economies should rise rather than decrease, and U.S. consumers are expected to continue to find foreign goods attractive. The trend of the ratio of imports to GNP has been strongly upward over the past two decades, and it is reasonable to expect it to continue to climb -- although almost certainly at a somewhat reduced rate.

While there are factors which will perhaps act to limit imports -- e.g., the production of domestic small cars more competitive with foreign car imports -- these factors appear at this time to be relatively less important than the probable expansionary factors.

Major Export Determinants:

- The two major determinants of the level of U.S. exports in the long-run will be the amount of economic growth which will occur in foreign economies and the degree to which the United States is competitive as a supplier in world markets.
- Also important, however, will be the structure of demand in the world -- that is, the changes in demand for products in which the United States has a revealed or potential comparative advantage in producing and selling abroad. The long-term competitive position of the United States can, of course, change overall and by product; and will depend upon underlying aspects of productivity, technological efficiency, relative price inflation, and changes in exchange rate parities.
- In addition, a variety of structural constraints and institutional impediments to U.S. exporters now exist. Besides international trade barriers and preferential trade agreements abroad, U.S. exporters now face costs not borne

by producers in many other countries -- anti-trust regulations, a discriminatory ocean freight rate structure, tax and credit disadvantages, pollution control costs, and comparative gaps in export marketing services. These may change over the long run to either increase or reduce U.S. exports, depending on U.S. and foreign governmental actions.

Assessment of the probable direction of changes in these factors indicates that U.S. exports may well grow less rapidly than imports over the next decade. Most observers expect that long-term growth in the other industrial nations will be slower than during the 1960s and early 1970s. Continuing foreign exchange earnings constraints are also expected to hold down growth in the non-oil LDCs. While expanded exports to the OPEC countries may act to counterbalance slower export growth to other markets, estimates of future OPEC absorption indicate that the most significant increase in OPEC import growth rates has already occurred.

Changes in U.S. competitiveness could have a positive or negative influence on our export growth. In addition to prices and exchange rates, U.S. competitiveness in the past has also depended upon the technological sophistication and rapid innovation of U.S. products. A reduction in our technological progress relative to our major competitors could have significant effects, both for the level and composition of U.S. trade.

If our competitive performance is as good on average as it has been in the past, U.S. export growth may be reduced nonetheless because of generally slower growth overseas than the past long-term trend. Competition for world markets for manufactured goods, moreover, will likely increase. Several LDCs are already becoming potent competitors in a widening range of manufactures. This trend is likely to accelerate and to include a growing number of LDCs. Enhanced LDC growth would, of course, offer expanded export markets. The nature of demand in those markets and our ability to offer the desired products at competitive terms will be crucial to our export success in these growing markets.

Differences in Income Elasticities -- As the Treasury pointed out in a recent paper on the trade deficit, econometric studies have generally found that U.S. imports are more income-elastic than U.S. exports. This means that a one percent increase in U.S. economic

activity will increase U.S. imports more than a one percent increase in foreign economic activity will increase U.S. exports. The divergence between our import and export income elasticities is believed to be related to the fact that we tend to export less income-elastic products (e.g., agricultural goods and capital goods) than we import (e.g., consumer goods).

This factor explains, at least in part, why U.S. imports tended to rise more rapidly than U.S. exports in the 1960s and early 1970s -- even though our economy was growing less rapidly than the economies of our major trading partners.* Few economists believe that the U.S. economy will grow more slowly than the economies of its major trading partners over the next ten years or so. It is generally believed that the opposite will be the case -- or at least that U.S. economic growth will be as fast as economic growth abroad.

A continuation of the observed divergence between our import and export income elasticities would, in this changed environment, imply that the tendency of U.S. imports to grow faster than exports would be even more pronounced than in the past. This carries the implication that trade could be a destabilizing element in future U.S. economic growth.

Illustrative Trade Projections -- Figure 9 is a guide to the orders of magnitude of potential exports and imports which are involved in projecting a possible U.S. trade position over the next decade. This example should be clearly recognized as the hypothetical result of alternative assumptions -- each of which are incomplete pictures of what may actually occur.

In assessing export and import growth, projections made with the Data Resources Inc. long-run U.S. model were used as a base for reference. These projections, which imply rates of expansion generally similar to those made by other observers, are based on somewhat lower than historical U.S. and developed world growth rates (particularly for industrial nations other than the U.S.), some success in energy conservation within the United States, and the additional oil from the North Slope.

* A highly important factor, which typically was not taken into account in the various econometric elasticities studies, was expanded foreign supply capabilities, particularly in Japan.

Reflecting the factors which may act to limit U.S. export expansion, an alternative case was computed for exports which takes account of both a possibly lower growth in the non-oil LDCs relative to the developed world (an important factor due to the importance of the LDC market to the United States) and lower estimates of OPEC absorption possibilities (which proceed at a rate differing from growth in the developed countries). This alternative export expansion rate was applied to the major product groups within manufactures, while agricultural goods and raw materials exports were assumed to expand at the trend level experienced in the past. The effect of these assumptions result in an export level some 6 percent less than the base export figure for 1985.

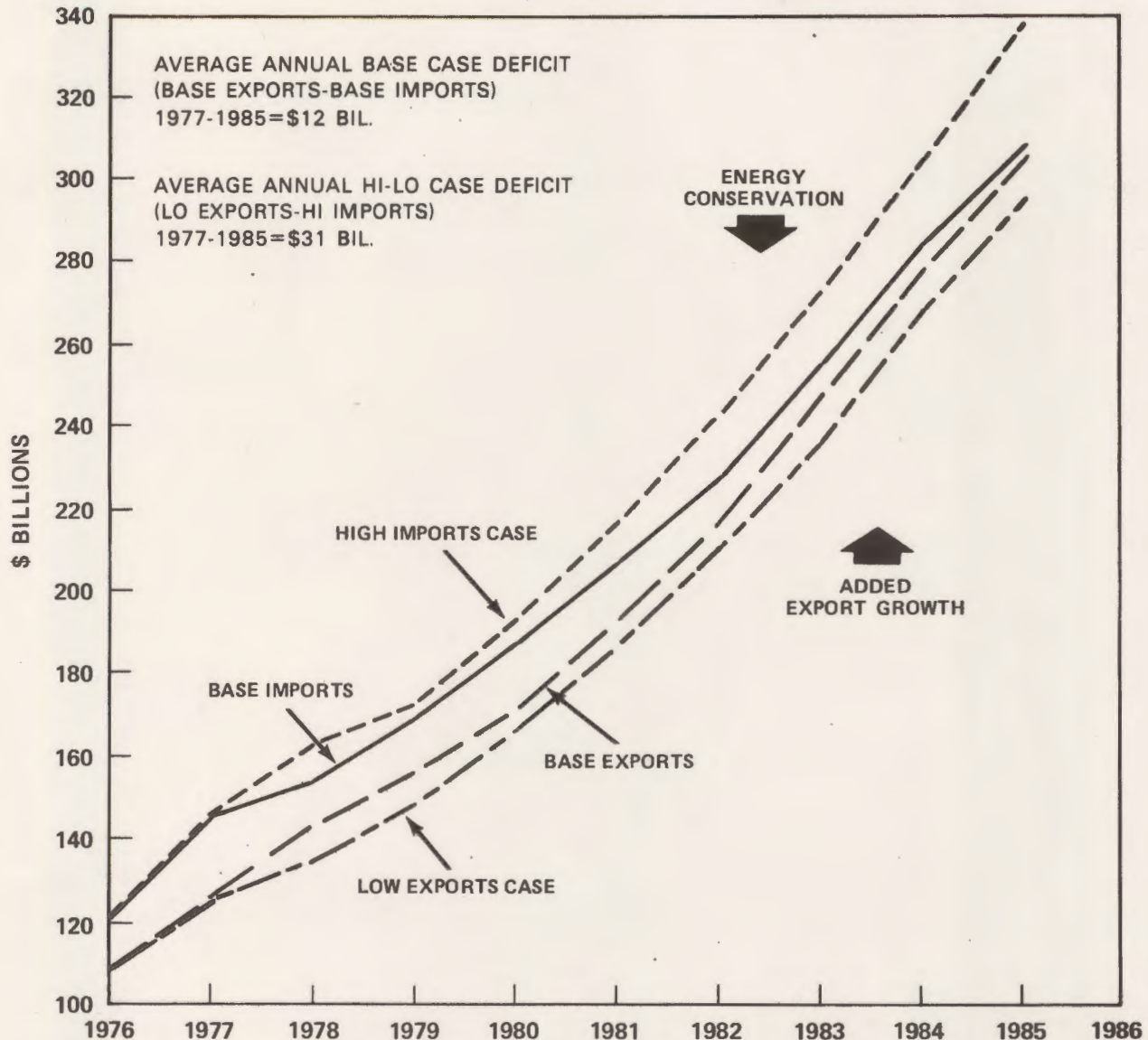
Alternative assumptions were also applied to U.S. imports. Maintaining the base case (DRI) non-oil import to GNP proportions, the rate of growth of the U.S. economy was increased moderately; and somewhat less success was assumed in energy conservation. An import level of about 8 percent above the base import projection by 1985 resulted.

While the alternative assumptions reflect minor changes in general, the result was a fairly large expansion in the hypothetical trade deficit. In the worst combination, shown in Figure 9, the U.S. trade deficit increased to over \$40 billion in 1985.

The imprecision involved in this approach is obviously large. Two considerations which are of importance, nonetheless, seem to be supported despite the degree of probable error. First, with continuing U.S. domestic growth a sharp turn-around in the U.S. deficit position does not seem to be indicated in the medium-term (through 1980). Second, it would appear at this time that most of the influences that will operate on the U.S. trade balance in the longer-run are factors which will tend (in the absence of compensating exchange rate changes) to maintain a deficit position for the United States.

FIGURE 9

ILLUSTRATIVE* LONGER-TERM EXPORT AND IMPORT LEVELS



- FACTORS EXIST WHICH — IN THE ABSENCE OF OFFSETTING ADJUSTMENTS — COULD CAUSE A CONTINUATION OF THE U.S. TRADE DEFICIT OVER THE NEXT DECADE
- EVEN IN THE MORE OPTIMISTIC PROJECTIONS, OBSERVERS SEE A SUBSTANTIAL U.S. DEFICIT POSITION THROUGH 1980 UNDER CURRENT CONDITIONS
- ADDITIONS TO EXPORT GROWTH AND REDUCED OIL IMPORTS THROUGH ENERGY CONSERVATION ARE THE MOST DESIRABLE CORRECTIVE ACTIONS

*THE PROJECTIONS SHOWN ARE NOT FORECASTS BUT ARE ILLUSTRATIVE BASED ON ASSUMPTIONS WHICH ARE SUBJECT TO ALTERNATIVE INTERPRETATIONS. BASE IMPORTS AND EXPORTS REFLECT DATA RESOURCES INC. MODEL PROJECTIONS.

Reality dictates that the oil-importing nations as a whole must share a huge combined deficit with the OPEC nations. As the largest oil importer, the United States necessarily must absorb a portion of this common deficit. Failure to bear our share of the deficit would be to pursue, in effect, a "beggar-thy-neighbor" policy. While the level of the U.S. deficit was manageable in 1976, the deficit is now at or near a size that is beginning to result in negative economic effects on the United States.

Appropriateness of the Deficit -- There is a beneficial aspect of a U.S. trade deficit at this time -- at least in theory. The greater the U.S. deficit, the smaller the deficit for the other oil importing countries as a group -- many of which are already in international financial trouble because of large trade and current account deficits. Moreover, higher U.S. imports are providing economic stimulus abroad, permitting export growth in foreign economies to contribute to their overall economic growth.

The distribution of the U.S. trade deficit, however, does not appear to be providing economic stimulus or balance of payments assistance to those who need it most. The United States has a \$6 billion trade deficit with Japan and a \$2 billion deficit with Canada. No other industrial nations are receiving major stimulus from the U.S. deficit.

Europe, in particular, is not benefitting. In fact, the flow is going the other way. The United States has a trade surplus at an annual rate of about \$8 billion with Western Europe (excluding Germany -- with which we have a small deficit). The recovery and financial difficulties of the European countries other than Germany can be seen in the fact that these nations have a combined trade deficit with the United States, Germany and Japan on the order of \$25 billion.

Nor is the U.S. trade deficit benefitting most LDCs -- particularly the least-developed countries. The United States has a deficit of over \$4 billion with the rapidly-developing economies of Hong Kong, Taiwan, and Korea (taken as a group); and a \$3 billion deficit with

Mexico and Brazil. However, the United States is in surplus with the rest of the LDCs. The five LDCs receiving the greatest stimulus from the U.S. deficit, moreover, have tended to accumulate reserves rather than to recycle the stimulus they have received.

There are limits to the size of the deficit in merchandise trade and in the overall current account which can be considered as an appropriate U.S. "share" in the common burden. There are no easy ways to define this level of deficit, but downward movements in the value of the dollar could be interpreted as an indicator that our portion may be excessive.

Effect on Current Account -- The merchandise trade deficit has adversely affected the outlook for the current account of the balance of payments. An excessively-large current account deficit could tend to push down the value of the dollar.

Merchandise trade is by far the largest of our current account transactions, but additionally there are transactions arising from "invisibles" -- earnings from foreign investment, royalties, transportation, tourism, other services, and unilateral transfers. The United States has traditionally had a small deficit in invisibles, but starting in 1974 invisibles have been in surplus,

The invisibles surplus in 1976 was large enough to basically offset the 1976 trade deficit. The invisibles surplus, however, is not large enough to prevent the present merchandise trade deficit from putting the overall current account into a large deficit.

Moreover, it is unlikely that the invisibles surplus will continue to show rapid growth -- and it may even decline. This is because the 1976 improvement stemmed basically from an increased proportion of earnings being remitted from overseas affiliates of U.S. firms. If economic conditions improve abroad it is likely more earnings will be re-invested overseas, thus reducing the invisibles surplus. Consequently, the outlook for the current account in the near term is not encouraging.

International Concerns -- The deficit is resulting in an outflow of dollars from the United States in quantities that are troubling foreign bankers. Large increases in foreign reserve holdings are resulting -- raising fears of a too-rapid rate of money growth abroad, which could spur inflation and lead to revaluation of some

foreign currencies. If foreign central banks become unwilling to continue accumulating balances, a decline in the dollar would become almost certain -- resulting in rising import prices adding to U.S. inflation, and a decline in the terms of trade that would reduce the U.S. standard of living.

DOMESTIC CONCERNS

GNP Growth -- Due to the large size of the merchandise trade deficit, net exports of goods and services are contributing much less to U.S. GNP growth than had been expected only six months ago. Imports have increased rapidly, but exports have shown only limited gains. Thus, while Germany and Japan have export-led GNP growth, the United States has export "drag". Expansion of exports this year at a rate that would maintain the level of the U.S. deficit of 1976, for instance, would mean some \$16 billion more in export sales than will likely be the case.

Attainment of U.S. economic growth and employment targets in 1977 and 1978 may well require added stimulus in other sectors to compensate for slower export growth. Moreover, if deficits continue over the next several years, continued additions to fiscal or monetary stimulus would be required, which would make the simultaneous achievement of a balanced budget by 1981 considerably more difficult.

Political Implications -- Business and labor are particularly concerned about the impact they feel the deficit is having on production and jobs. Labor has translated the trade deficit into lost jobs, and protectionist sentiment among labor leaders has been growing. The business community is troubled by the deficit's effect on output, with the loss of growth in domestic sales to rising imports being inadequately offset by an expansion in foreign sales.

Business confidence may also be affected. Business tends to regard trade deficits, like budget deficits, as a negative signal. Businessmen have been particularly concerned by what they consider as a lack of attention to the problem in Washington.

Congress is not unaware of the feelings of business and labor, and continued deficits are likely to accelerate the demands for import protection. Import protection is an ineffective way to increase jobs, however, for it reduces U.S. consumption and results in

inefficient use of resources. More importantly, U.S. moves toward protection -- particularly if they affected European countries -- could, in today's volatile economic world, easily result in a domino effect of import restrictions that would be difficult to stop and which could reduce world production and income.

Another problem stems from the fact that the United States is the only major nation with a large trade or current account deficit. Both sophisticated and simplistic questions are being raised in comparing the U.S. deficit with the large surpluses of Japan and Germany. The United States, indeed, does appear to be bearing more than its share of the adjustment burden, and efforts with Japan and Germany to do more are perceived as having had little effect.

Assessment of the Implications -- As we see it, the major element of concern regarding the deficit is the question of our ability to expand exports, now and in the longer-run, in order to meet our oil import needs and still enjoy a high level of desirable non-oil imports from abroad.

The mounting deficit is a sign that we may not have the ability that we would like to have in this regard. If trends continue as we now see them, the level of non-oil imports which would be desirable and commensurate with a strongly expanding, full-employment economy will continue in both the near-term and longer-term to outpace the likely level of exports under present conditions and policies.

To sum up:

- The trade deficit has reached the point at which its economic and political costs are a matter of no small concern.
- Prospects for the 1978 trade balance do not show a high probability of improvement.
- The longer-term outlook, while uncertain, contains more negative than positive factors.
- The risks of continued, unaddressed deficits would be substantial in terms of the domestic economy and world economic growth and stability.

The Department therefore concludes that the implications of the present and prospective deficits warrant action by the Administration. The Department believes the prudent course is to take carefully-selected actions now, with the optimal course being: (1) to continue determined efforts to reduce the need for oil imports; and (2) to increase U.S. exports by improving the export climate and reducing obstacles to exporting.

Anemic growth of exports, rather than rising imports, is the foreign trade factor which is putting a drag on our GNP growth. Our non-oil import increases for the most part have been the natural consequence of our economic growth. Our exports, though, have been considerably short of the expectations that have gone into U.S. economic recovery and growth plans.

Foreign economic growth, international price competitiveness, and foreign trade barriers are the main determinants of our export growth. There are other potent forces affecting our exports, however. Many of these are institutional or marketing obstacles -- and many of them have been U.S. Government-imposed. Their reduction or elimination would act to increase U.S. exports, and the Department believes this should be attempted.

The size of the present deficit is largely intractable in the near term. There are, however, policy actions which could be initiated now to beneficially affect the U.S. trade position over the longer-term. These would also have the immediate advantage of demonstrating that positive and constructive actions are being taken by the Administration.

Because many of the possible policy responses to the deficit would be detrimental to U.S. and world economic interests, we are anxious that the Administration be able to retain the initiative in this area, rather than being forced into a defensive posture.

MEASURES TO BE AVOIDED

Some of the policy options which might be considered in an attempt to unilaterally redress the overall deficit, the deficit in particular products, or the deficit with particular countries would be undesirable and counterproductive. Part of our concern over the need for Administration action reflects our desire to forestall pressures for their imposition and we strongly urge that the following measures be avoided.

Imposition of Import Restraints -- It should be stressed that import restrictions would have definite adverse effects on the U.S. domestic economy. Import restrictions would be inflationary, both for the prices of restricted items and subsequently for prices in general. Restrictions on imports would also result in a loss of real income by consumers and by producers as a whole.

Moreover, if the United States were to impose import restrictions under the present circumstances, this would almost certainly lead to a series of countervailing actions by other nations in which our total economic interests clearly would be set back.

Excessive Reliance on Exchange Rate Movements -- With the floating rate system, the United States could pursue a "hands off" policy and allow exchange rates to adjust. If the deficit does persist at its current rate, some equilibrating movements in exchange rates would almost certainly take place without any explicit government action. The size of the movement would depend not simply on the trade or current account deficit but also on net capital flows and, in particular, the degree to which foreigners continue to have confidence in the dollar.

A fall in the price of the dollar, however, would not be costless: imports would become more expensive, negatively affecting our terms of trade and increasing domestic inflationary pressures. A falling dollar would reduce OPEC real earnings per barrel of oil sold, and could easily prompt added oil price increases. Moreover, a policy of doing nothing could weaken confidence in the dollar to the extent that the resulting dollar devaluation might be larger than justified on strictly economic grounds.

Reduction in U.S. Growth -- The continued strong recovery of the U.S. economy is certainly a major factor in the rapid growth of U.S. imports in 1977. Dampening U.S. economic growth to reduce the size of the trade deficit might have validity under certain conditions, but is inadvisable in an economy running at less than full employment. Such a policy would jeopardize Administration goals in the areas of unemployment and a balanced budget. The costs of reducing U.S. economic growth because of the need to curtail a trade or current account deficit would be enormous in terms of employment and real income.

POSITIVE MEASURES TO REDUCE THE DEFICIT

Reduction of Oil Imports -- The most significant action which the United States could undertake to reduce the likelihood of continuing trade deficits is to reduce its need for oil imports. Reduced dependence on imported oil through increased conservation measures and longer-term actions to stimulate domestic oil production are already provided for in the Administration's energy package. The possibility of continued trade deficits of a significant size, we believe, underscores once again the need for a reduction in longer-term oil imports.

The effect on the U.S. trade balance of these measures, however, will not be evident for some time. The specter of drastically increased oil prices beginning in the mid-1980s, moreover, raises the possibility that the beneficial trade impact of a reduction or slower growth in the quantity of U.S. oil imports may be at least partially offset by higher oil prices.

OBTAINING ADDED EXPORT GROWTH

The United States has unutilized export potential that stems from foreign barriers, from insufficient foreign market knowledge on the part of many companies, from institutional barriers -- some of which were created by the U.S. Government -- and from a degree of foreign government export assistance substantially in excess of that provided by the United States.

The Department believes that the United States should attempt to more fully utilize its export potential by removing as many of these barriers and hinderances as possible. To the extent that exports are successfully increased, the pressures of potential future trade deficits would be reduced -- as would the magnitude of the dollar decline or other economic adjustments that might be imposed by continued deficits.

Most of these positive actions, moreover, should be undertaken in any event -- regardless of whether or not the United States has a trade deficit. The fuller utilization of export potential contains terms-of-trade and other economic benefits of significant value to the U.S. economy.

More Rapid Economic Growth Abroad -- Inducing a faster rate of economic recovery abroad would be the most effective means of stimulating faster U.S. export growth. Unfortunately, it is also proving to be an extremely difficult objective to achieve. A major problem for world economic recovery -- and hence U.S. exports -- is that neither the German nor the Japanese economy has recovered at a rate sufficient to generate significant growth in demand for the exports of other countries. A second major problem is that both of the economies have so far fueled their slow recoveries by relying on export growth.

Both countries fear that inflation would result from stimulation of their domestic economies, but their fears of generating large amounts of incremental inflation appear to be exaggerated. There is no evidence of demand-pull inflation in their economies. Their economic behavior is resulting in further devaluations and reductions in growth in other countries struggling to bring their external accounts into balance.

The United States should continue forceful and pointed consultations with Japan and Germany, urging their stimulation of domestic activity -- even though the chances of success may appear remote.

Exchange Rate Manipulation -- Foreign manipulation of exchange rates to gain an undue trade advantage should be forcefully dealt with. The United States needs to more closely monitor exchange rate movements and foreign government intervention to ensure that movements are consistent with basic economic conditions.

Trade Policy -- While the reciprocal nature of the MTN makes it unlikely that its successful conclusion will have a major impact on the aggregate size of the U.S. deficit, the objectives already sought are impressive, and the MTN should be emphasized as strongly as possible. In addition to increasing U.S. benefits from trade, the high visibility of an international effort to reduce trade barriers serves as a countervailing force against the unilateral imposition of trade restrictions.

In addition to the MTN, we believe that bilateral negotiations may, in some cases, be needed to induce more open markets and distribution systems in countries where these factors represent significant barriers to U.S. exports.

Domestic Economic and Regulatory Policies -- A variety of U.S. policies affect exports. DISC is of particular significance in the area of taxation, and there are valid reasons for maintaining this element of our trade policy in at least its current form. DISC should not be discarded because of considerations based on previous and controversial evaluations of the initial form of the DISC. In fact, the Department believes it should be expanded by offering 100 percent deferral on the initial \$25,000 of taxable income of a DISC. This would be a needed incentive for smaller firms, of which many thousands are prospective exporters.

Other domestic policies which impede otherwise competitive exportable products include transportation policies that discriminate against exports and inadequate application of the Webb-Pomerene anti-trust exemption. Many of these policies have been discussed for years without effective action -- and still remain as U.S. Government-imposed restrictions on U.S. exports.

Export Financing -- Access to credit facilities and competitive terms needs to be widened, both because of the rising importance of financing in export sales and because of accelerated foreign competitor actions. The Department believes this should include expansion in Export-Import Bank funding authority, local cost coverage, and revival of the export expansion fund.

Expanded Export Promotion Efforts -- To date only about 20,000 out of 300,000 U.S. manufacturers export, and up to an additional 25,000 have been estimated to have unutilized export potential. Revitalized promotional, developmental, and marketing programs are needed to raise the number of U.S. exporters. The United States currently maintains proportionately one of the smallest export assistance programs of any major nation.

Increased Efforts to Expand Agricultural Exports -- Agricultural products will remain one of the areas in which the United States has an extremely strong comparative advantage. Efforts need to be continued to reduce or eliminate foreign constraints to U.S. agricultural exports -- and to prevent new barriers from being constructed.

FOR OFFICIAL USE ONLY

FOR OFFICIAL USE ONLY

U.S. FOREIGN TRADE IN 1977

**U.S. DEPARTMENT OF COMMERCE
Domestic and International Business
Administration**

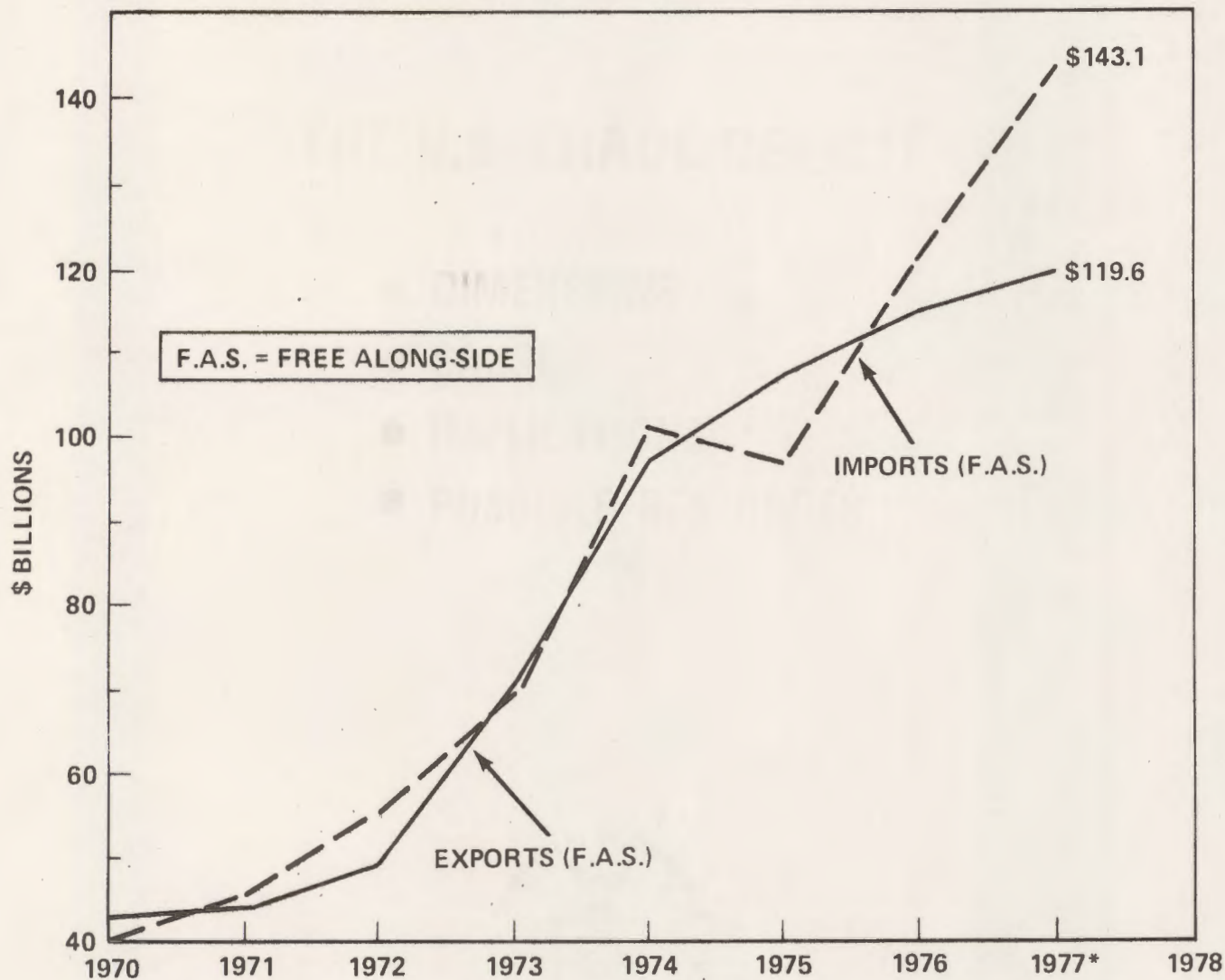
JULY, 1977

U.S. FOREIGN TRADE IN 1977

**U.S. DEPARTMENT OF COMMERCE
Domestic and International Business
Administration**

JULY, 1977

U.S. IMPORT GROWTH CONTINUES TO EXCEED EXPORT GROWTH IN 1977



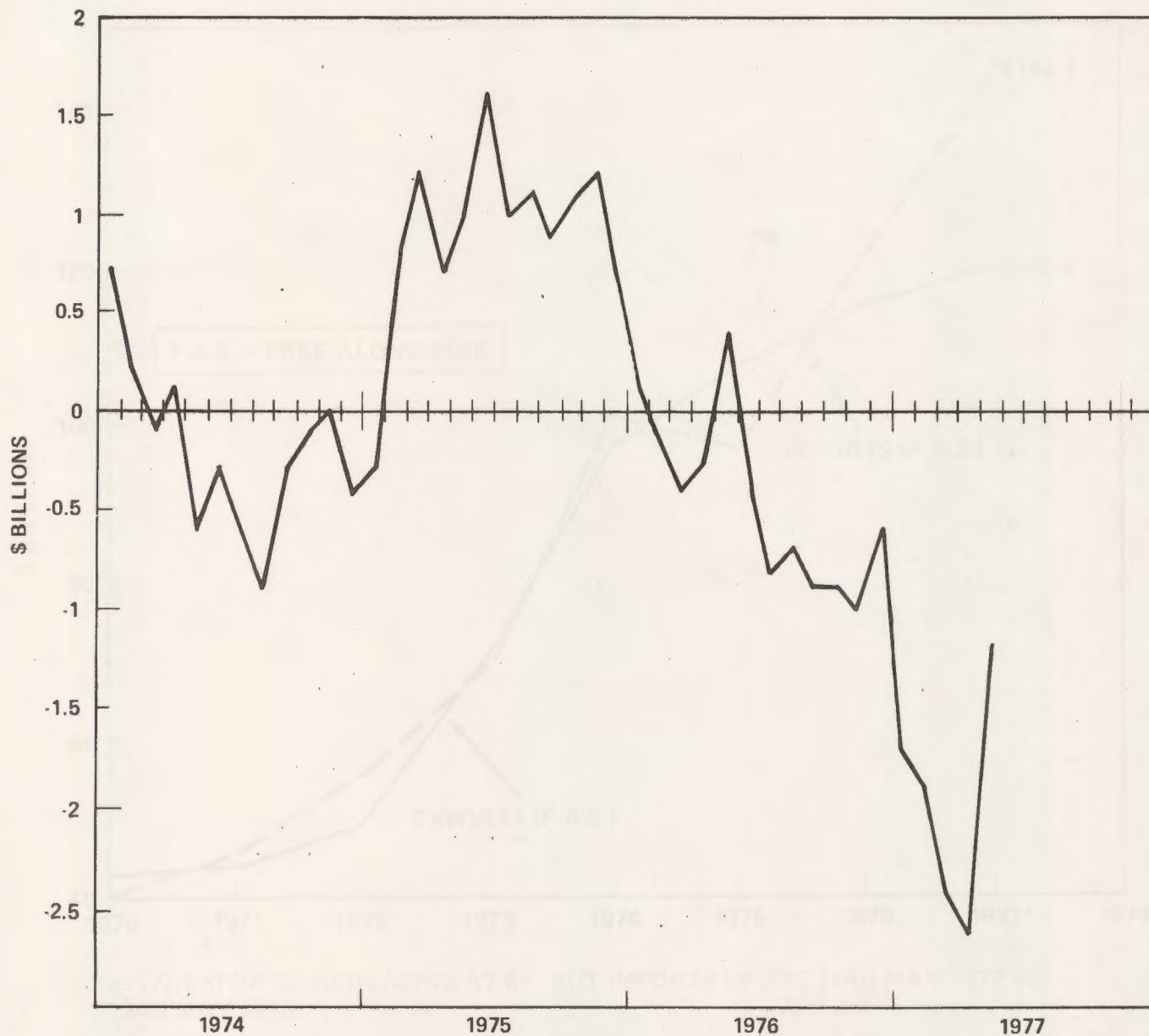
● 1977 EXPORTS INCREASING AT 8%, BUT IMPORTS UP 29%. (JAN-MAY 1977 VS. JAN-MAY 1976)

● TRADE DEFICIT THRU MAY AT ANNUAL RATE OF \$23.4 BILLION

● 1976 DEFICIT WAS \$5.9 BILLION AND 1975 TRADE WAS IN SURPLUS BY \$11.0 BILLION

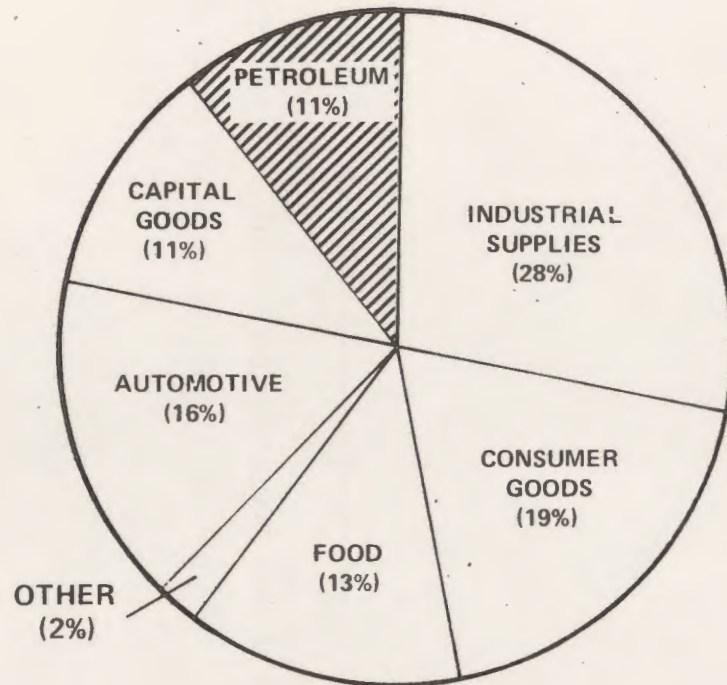
* 1977 DATA ARE JAN-MAY SEASONALLY ADJUSTED AT AN ANNUAL RATE

U.S. MERCHANDISE TRADE BALANCE DETERIORATES FURTHER IN 1977 (F.A.S. BASIS)



- JAN-MAY 1977 DEFICIT \$9.8 BILLION; \$23.4 BILLION AT ANNUAL RATE
- LAST 12 MONTHS HAVE CONSISTENTLY BEEN IN DEFICIT

COMMODITY COMPOSITION OF U.S. IMPORTS

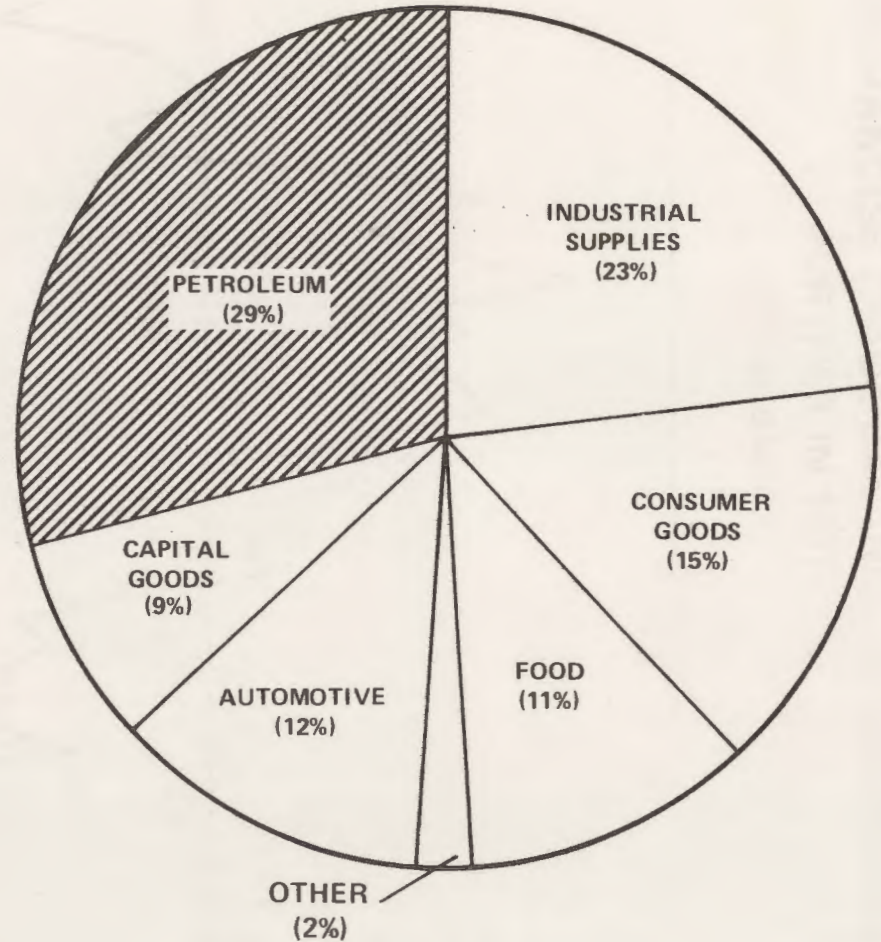


1973

- TOTAL IMPORTS \$69 BILLION IN 1973, \$143 BILLION IN 1977

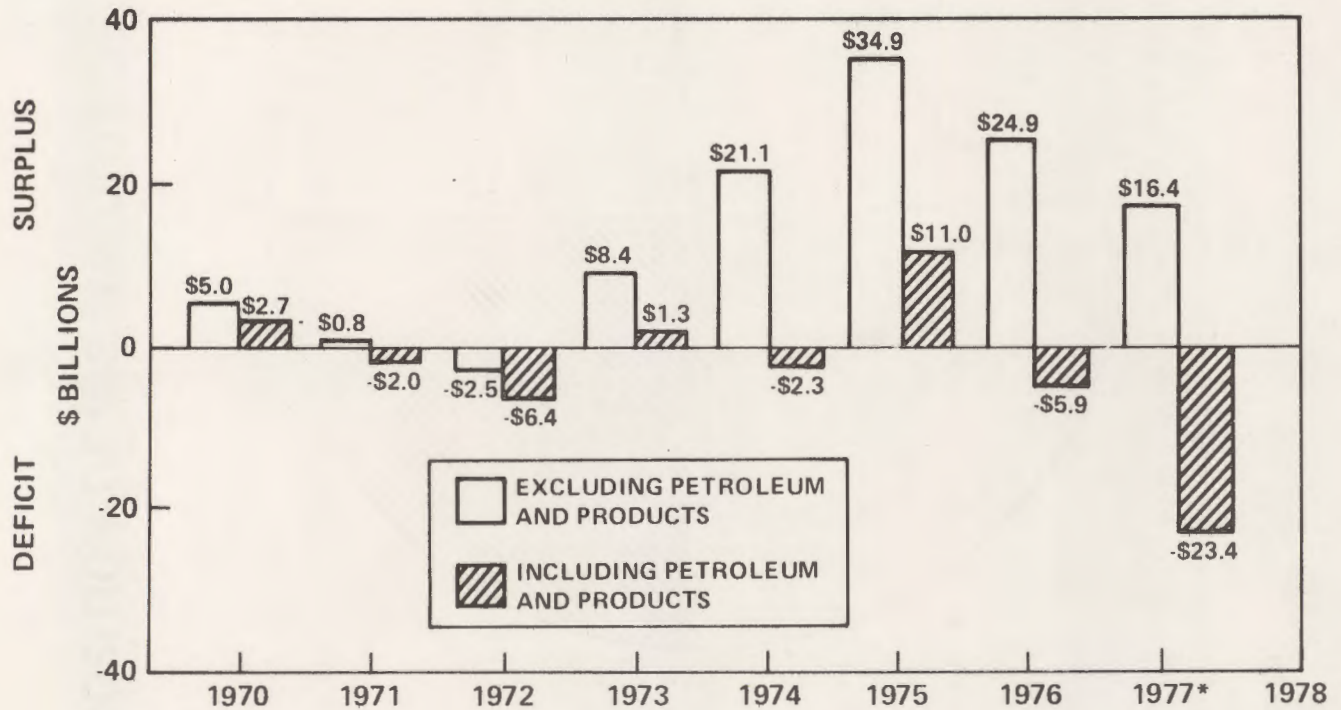
- OIL, ONLY 11% IN 1973, NOW 29%
VALUE ROSE FROM \$7.5 BILLION
TO \$41 BILLION

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED



1977*

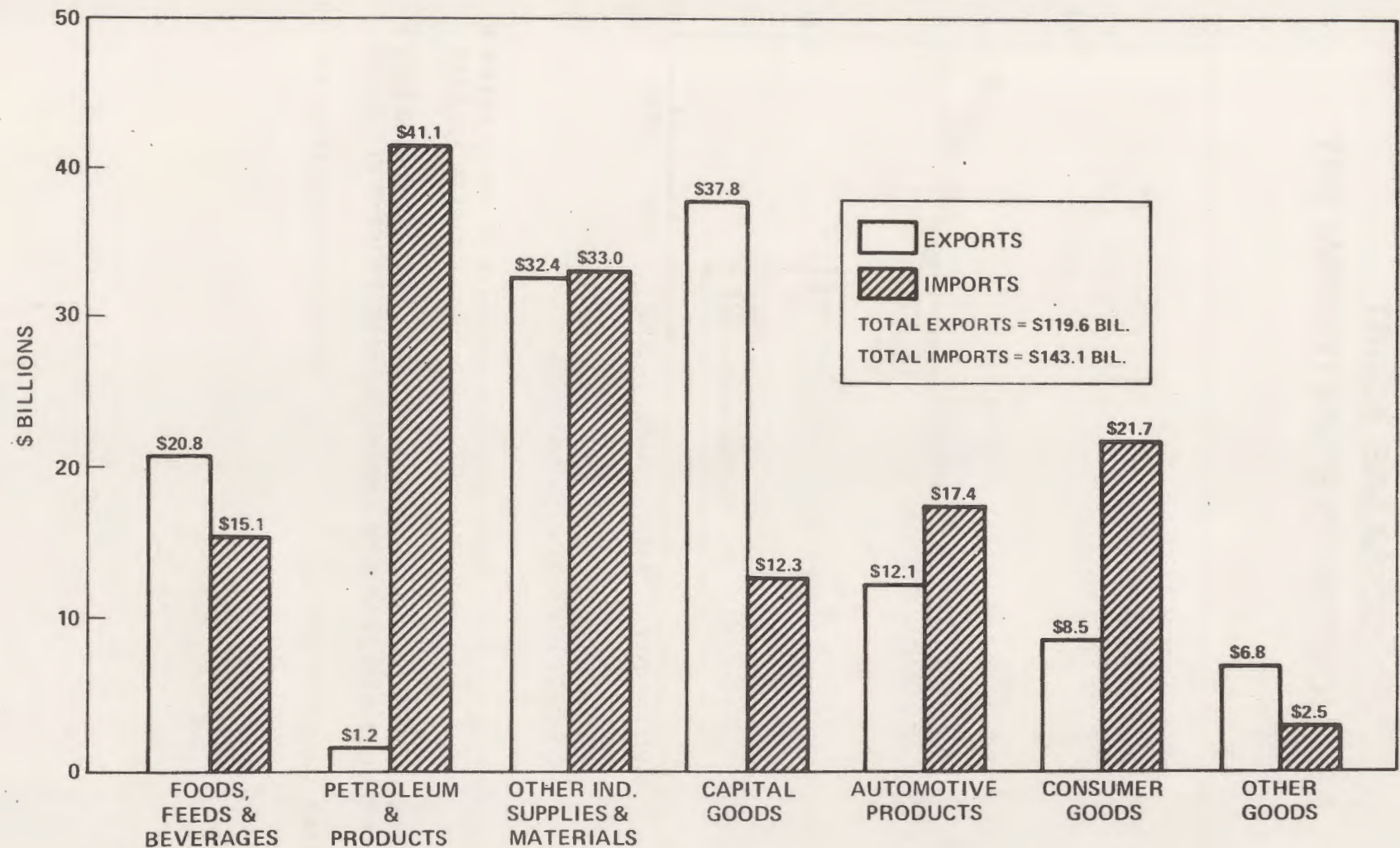
TRADE BALANCE: THE IMPORTANCE OF PETROLEUM



- TRADE SURPLUS IN PRODUCTS OTHER THAN PETROLEUM CONTINUES TO DECLINE IN 1977
- THIS SURPLUS IS DECLINING AT AN \$8 BILLION ANNUAL RATE WHILE THE DEFICIT IN PETROLEUM IS EXPANDING AT A RATE OF \$ 9 BILLION

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

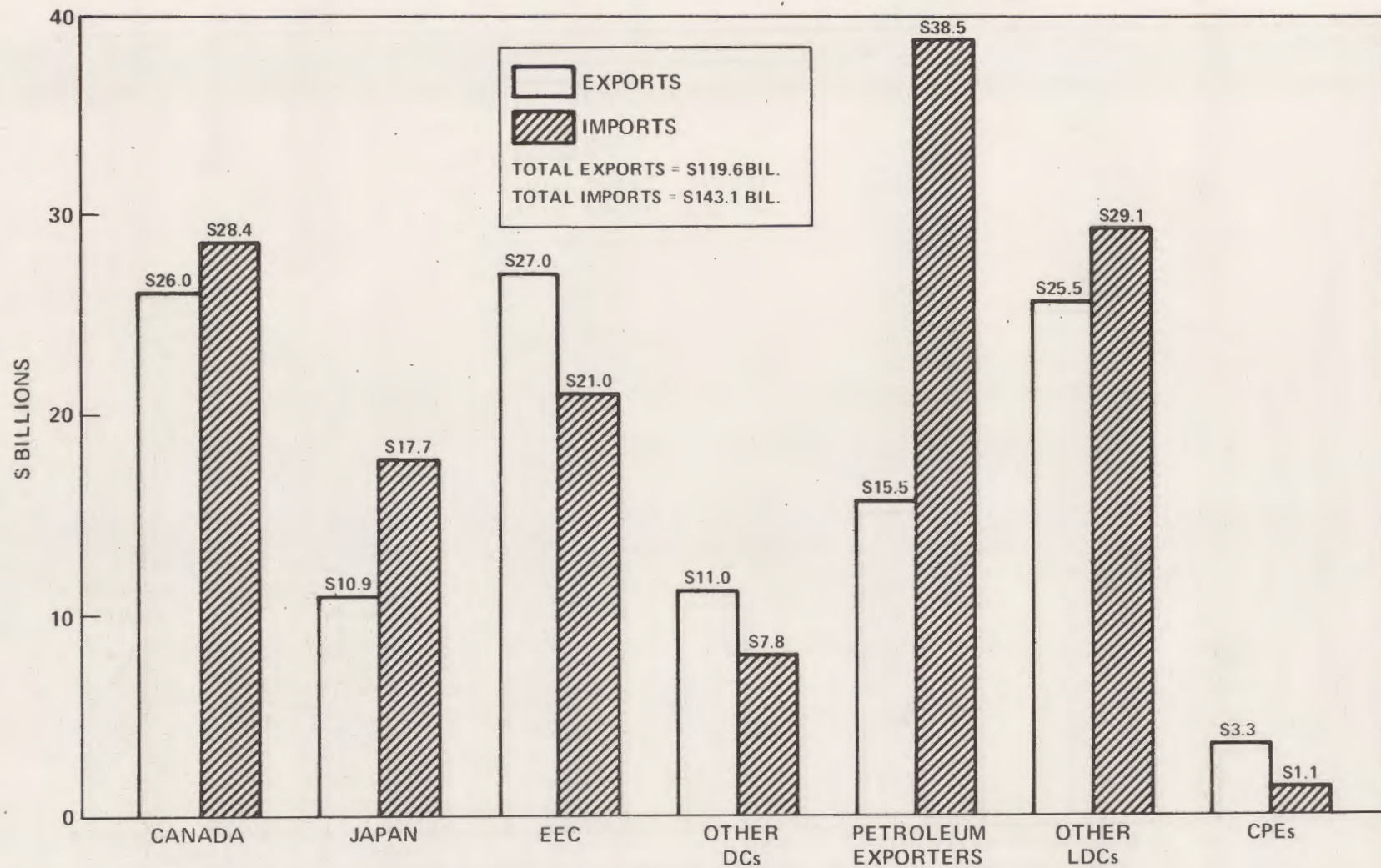
1977 U.S. EXPORTS & IMPORTS BY MAJOR PRODUCT GROUP



- 1977 TRADE BALANCE DECLINING AT A \$17.6 BILLION ANNUAL RATE
- EXPORTS INCREASING BY \$4.8 BILLION, BUT IMPORTS UP \$22.4 BILLION

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

1977 U.S. EXPORTS & IMPORTS BY REGION

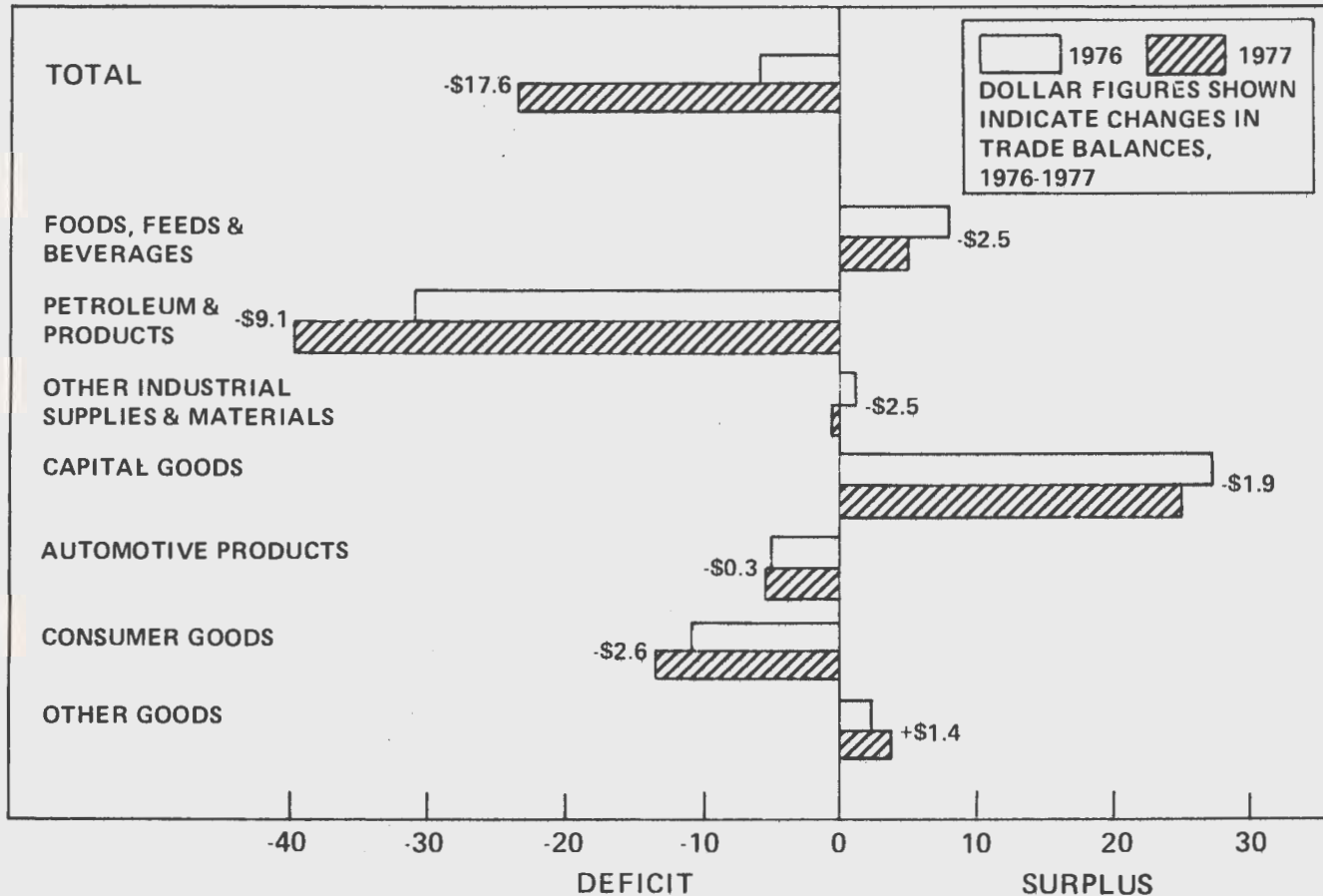


- EXPORTS FALL \$0.2 BILLION TO NON-OIL LDCs, WHILE IMPORTS UP \$5.7 BILLION
- TRADE DEFICIT WITH PETROLEUM EXPORTERS INCREASING AT \$8.5 BILLION ANNUAL RATE, AND DEFICIT WITH DCs UP BY \$3.6 BILLION

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

1977 TRADE BALANCE DECLINES IN ALL MAJOR PRODUCT CATEGORIES . . .

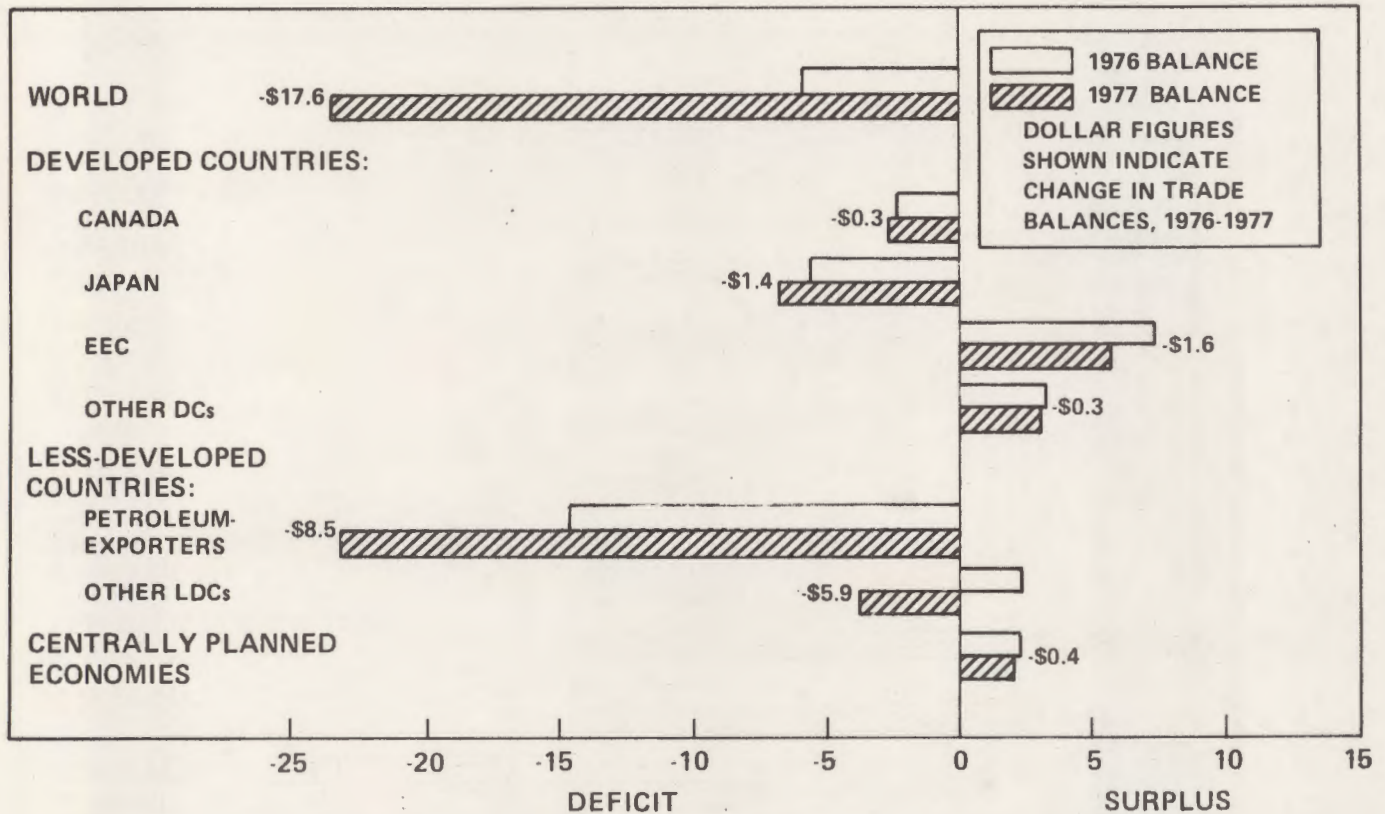
(\$ BILLIONS)



- OVER ONE HALF OF DETERIORATION IN PETROLEUM; BUT LOSS IN OTHER PRODUCTS ALSO SIGNIFICANT
- FASTEST IMPORT GROWTH IN FOODS, FEEDS & BEVERAGES(44%) AND PETROLEUM(48%)
- SLOW EXPORT GROWTH (3%) IN IMPORTANT CAPITAL GOODS CATEGORY (JAN-MAY 1977 VS. JAN-MAY 1976)

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATES

... AS WELL AS WITH ALL REGIONS (\$ BILLIONS)



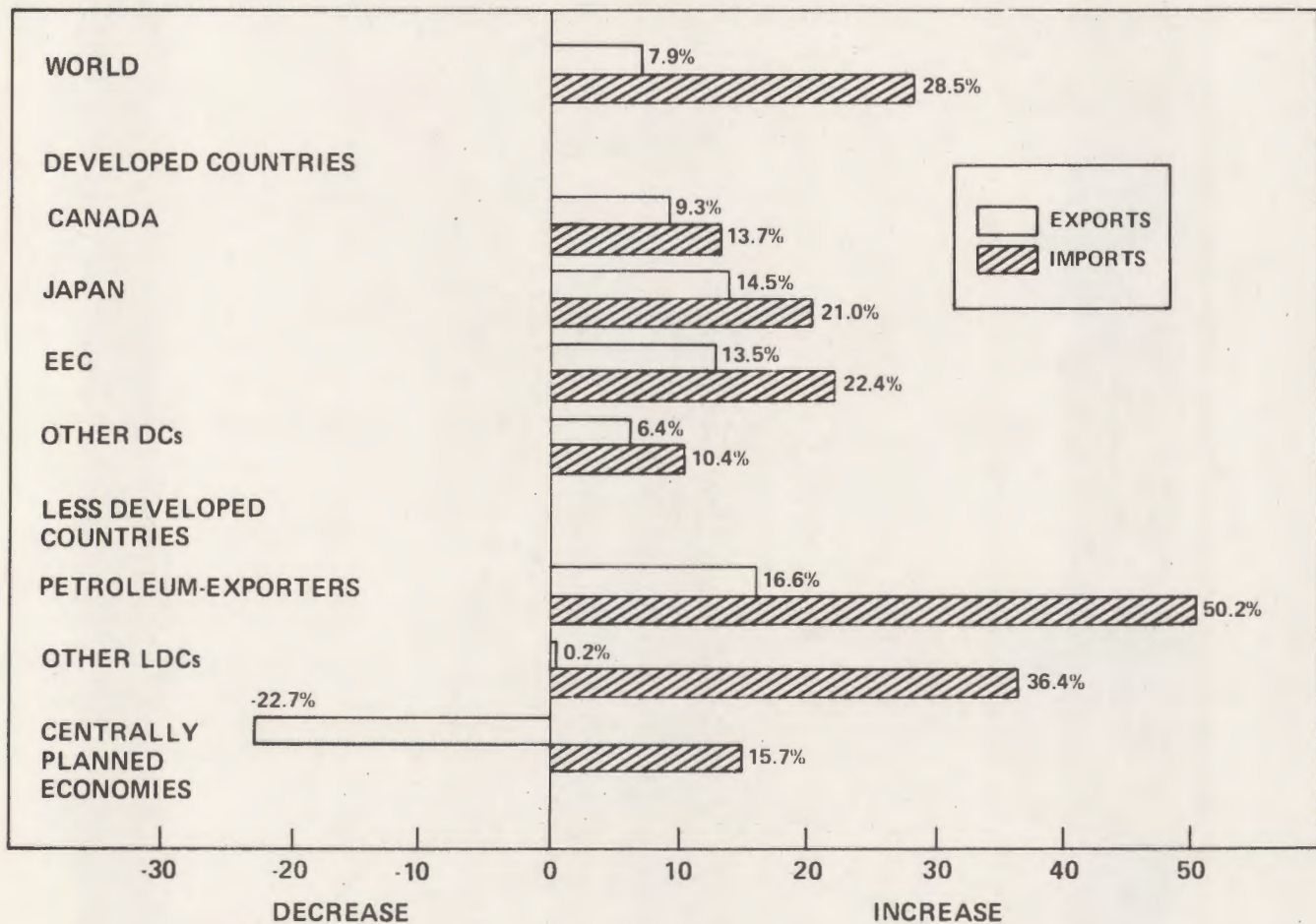
● LARGEST TRADE BALANCE DECLINES WITH PETROLEUM-EXPORTERS, NON-OIL LDCs, EEC AND JAPAN

● FIRST U.S. DEFICIT (\$3.6 BILLION) WITH NON-OIL LDCs THIS-DECADE

*1977 DATA BASED ON JAN-MAY SEASONALLY ADJUSTED AT ANNUAL RATE

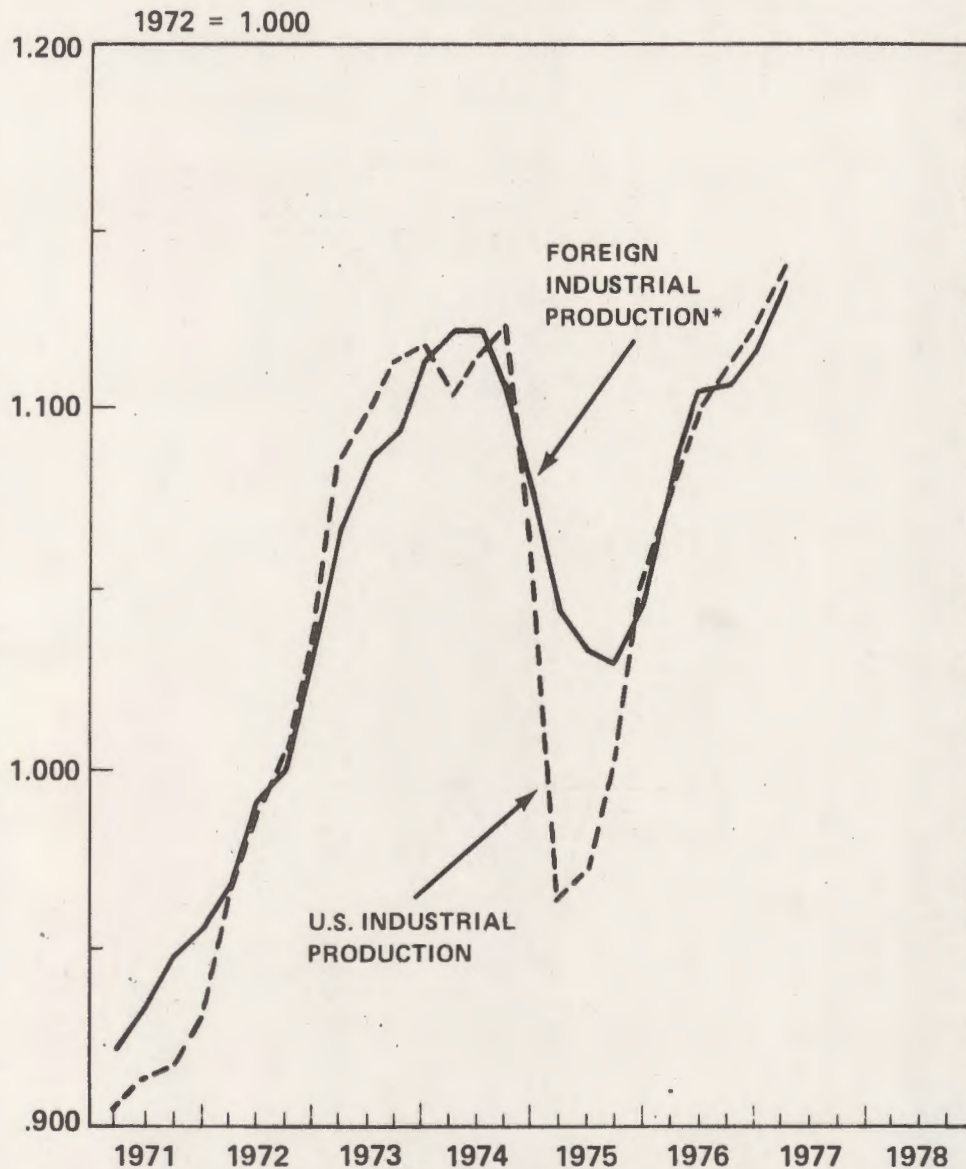
1977 GROWTH IN U.S. EXPORTS AND IMPORTS BY REGION

(FIRST FIVE MONTHS OF 1977 VS. FIRST FIVE MONTHS OF 1976, PERCENTAGE CHANGE)



- FASTEST U.S. IMPORT GROWTH FROM:
 PETROLEUM EXPORTERS
 EEC
 JAPAN AND NON-OIL LDCs – CONSUMER PRODUCTS
- FASTEST U.S. EXPORT GROWTH TO:
 PETROLEUM-EXPORTERS
 EEC AND JAPAN
- NO GROWTH IN U.S. EXPORTS TO NON-OIL LDCs FOR SECOND CONSECUTIVE YEAR

U.S. RECESSION DEEPER BUT RECOVERY FASTER THAN FOREIGN ECONOMIES



- U.S. PRODUCTION DECLINE LARGER THAN FOREIGN: 14% BELOW PREVIOUS PEAK VS. 8% FOR FOREIGN PRODUCTION
- BY 1977 BOTH U.S. AND FOREIGN PRODUCTION RECOVERIES ABOUT EQUAL: U.S. PRODUCTION WAS 1.3% ABOVE PRE-RECESSION PEAK AND FOREIGN PRODUCTION 1.2%

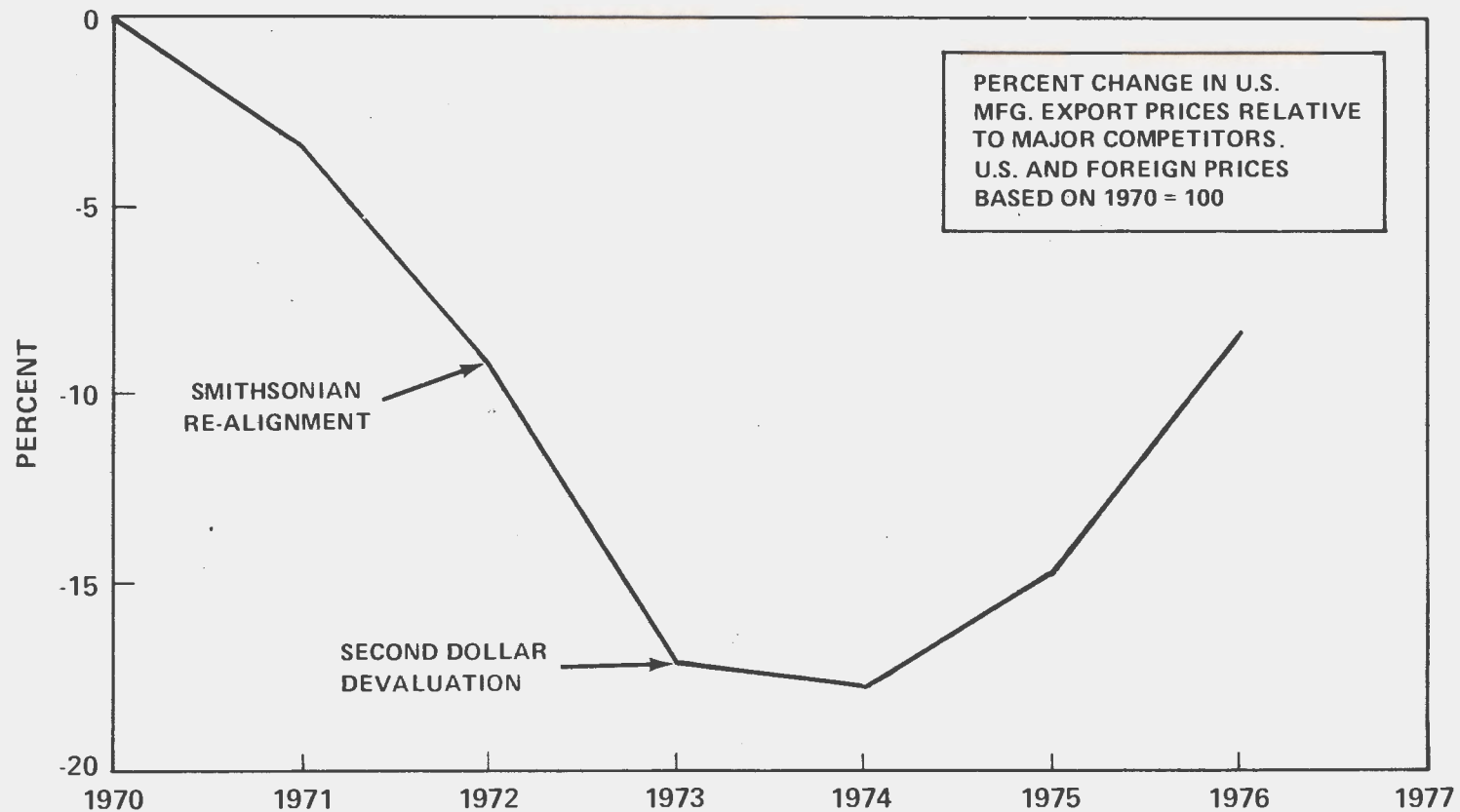
*CANADA, FRANCE, GERMANY, ITALY, JAPAN, AND UNITED KINGDOM

CYCLICAL FACTORS CONTRIBUTED STRONGLY TO U.S. 1975 TRADE SURPLUS, BUT CYCLICAL FACTOR RELATIVELY MILD SINCE THEN



- RATIO OF FOREIGN INDUSTRIAL PRODUCTION TO U.S. INDUSTRIAL PRODUCTION INCREASED DRAMATICALLY IN 1975
- RATIO RETURNED TO PRE-RECESSION LEVELS BY 1976, NOT SHOWING SIGNIFICANT DOWNWARD PRESSURE ON TRADE BALANCE THRU 1977 I

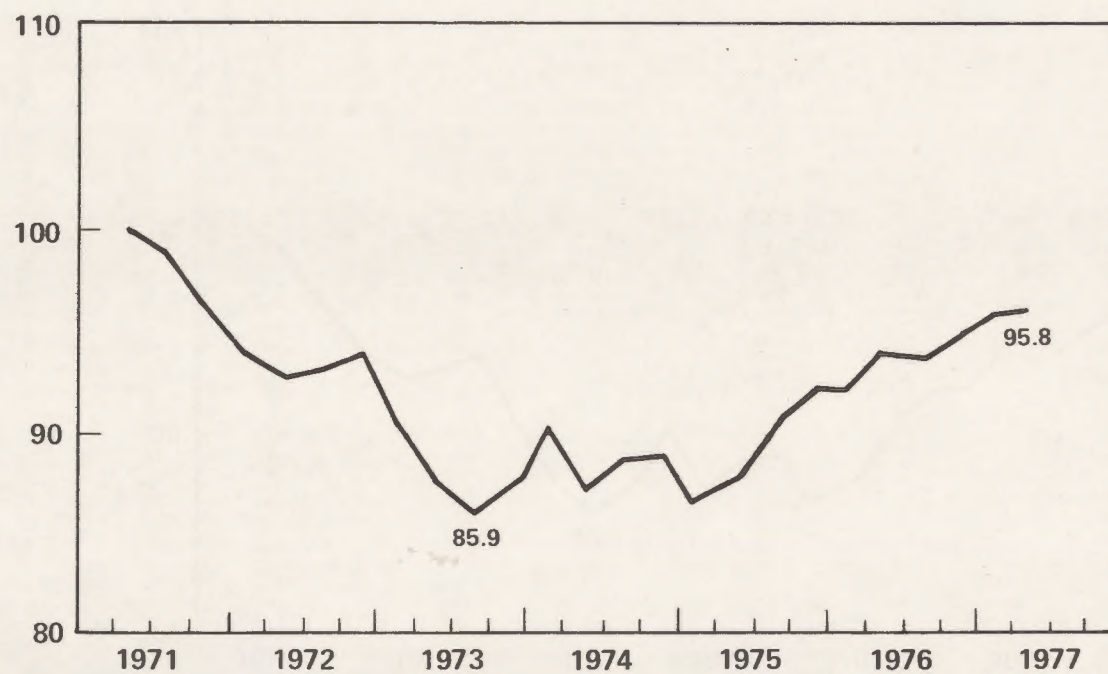
U.S. EXPORT PRICE COMPETITIVENESS IN MANUFACTURES DETERIORATING



- U.S. EXPORT PRICES FOR MANUFACTURES BEGIN RISING MORE RAPIDLY THAN FOREIGN MANUFACTURES PRICES IN 1975
- MUCH OF THE PRICE COMPETIVENESS GAINED FROM FEBRUARY 1973 DEVALUATION LOST

FOREIGN CURRENCY COST OF U.S. DOLLARS BASED ON 14 INDUSTRIAL COUNTRIES

(1971 II = 100)



● COST TO FOREIGNERS OF U.S. DOLLARS INCREASING SINCE 1975

THE WHITE HOUSE
WASHINGTON

WAS PULLED

Date: August 5, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
Charlie Schultze - *will comment*

FOR INFORMATION:

The Vice President
Hamilton Jordan *nc*
Jody Powell
Bert Lance - *attached*
Z. Brzezinski - *with comment*

See
confidential
attachment

FROM: Rick Hutcheson, Staff Secretary

SUBJECT:

Stu Eizenstat/Bob Ginsburg memo 8/4/77
Re: The Trade Deficit (At President's Request)

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: NOON
DAY: MONDAY
DATE: AUGUST 8

ACTION REQUESTED:

☒ Your comments
Other:

STAFF RESPONSE:

☐ I concur. ☐ No comment.
Please note other comments below:

omit
NSC
gone
comment

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

THE WHITE HOUSE
WASHINGTON

WAS PULLED

Date: August 5, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
Charlie Schultze - *with comment*

FOR INFORMATION:

The Vice President
Hamilton Jordan *nc*
Jody Powell
Bert Lance - *attached*
Z. Brzezinski - *with comment*

*See
confidential
attachment*

FROM: Rick Hutcheson, Staff Secretary

SUBJECT:

Stu Eizenstat/Bob Ginsburg memo 8/4/77
Re: The Trade Deficit (At President's Request)

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: NOON
DAY: MONDAY
DATE: AUGUST 8

ACTION REQUESTED:

☒ Your comments
Other:

STAFF RESPONSE:

☐ I concur.
Please note other comments below:

☐ No comment.

*omit
NSC
joined
commentary*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

MEMORANDUM
OF CALL

TO: _____

☐ YOU WERE CALLED BY—

☐ YOU WERE VISITED BY—

OF (Organization) _____

☐ PLEASE CALL —→

PHONE NO.
CODE/EXT. _____

☐ WILL CALL AGAIN

☐ IS WAITING TO SEE YOU

☐ RETURNED YOUR CALL

☐ WISHES AN APPOINTMENT

MESSAGE

Should has NO
Comment on Trade
Deficit Memo

RECEIVED BY _____

DATE _____

TIME _____

STANDARD FORM 63
REVISED AUGUST 1967
GSA FPMR (41 CFR) 101-11.6

GPO : 1969-O-43-16-80341-1 332-389

63-108

THE WHITE HOUSE
WASHINGTON

RICK:

As a result of conversations with
CEA and as a result of Randy Jayne's
memo, we have revised the Trade
Deficit memo to accommodate their
desires.

Stu Eizenstat

12 Aug 77

THE WHITE HOUSE
WASHINGTON

<input checked="" type="checkbox"/>	FOR STAFFING
<input type="checkbox"/>	FOR INFORMATION
<input type="checkbox"/>	FROM PRESIDENT'S OUTBOX
<input type="checkbox"/>	LOG IN/TO PRESIDENT TODAY
<input type="checkbox"/>	IMMEDIATE TURNAROUND

ACTION	
FYI	

<input checked="" type="checkbox"/>	MONDALE
<input type="checkbox"/>	COSTANZA
<input type="checkbox"/>	EIZENSTAT
<input checked="" type="checkbox"/>	JORDAN
<input type="checkbox"/>	LIPSHUTZ
<input type="checkbox"/>	MOORE
<input checked="" type="checkbox"/>	POWELL
<input checked="" type="checkbox"/>	WATSON
<input checked="" type="checkbox"/>	LANCE
<input checked="" type="checkbox"/>	SCHULTZE

<input type="checkbox"/>	ENROLLED BILL
<input type="checkbox"/>	AGENCY REPORT
<input type="checkbox"/>	CAB DECISION
<input type="checkbox"/>	EXECUTIVE ORDER
	Comments due to Carp/Huron within 48 hours; due to Staff Secretary next day

<input type="checkbox"/>	ARAGON
<input type="checkbox"/>	BOURNE
<input checked="" type="checkbox"/>	BRZEZINSKI
<input type="checkbox"/>	BUTLER
<input type="checkbox"/>	CARP
<input type="checkbox"/>	H. CARTER
<input type="checkbox"/>	CLOUGH
<input type="checkbox"/>	FALLOWS
<input type="checkbox"/>	FIRST LADY
<input type="checkbox"/>	HARDEN
<input type="checkbox"/>	HUTCHESON
<input type="checkbox"/>	JAGODA
<input type="checkbox"/>	KING

<input type="checkbox"/>	KRAFT
<input type="checkbox"/>	LINDER
<input type="checkbox"/>	MITCHELL
<input type="checkbox"/>	MOE
<input type="checkbox"/>	PETERSON
<input type="checkbox"/>	PETTIGREW
<input type="checkbox"/>	POSTON
<input type="checkbox"/>	PRESS
<input type="checkbox"/>	SCHLESINGER
<input type="checkbox"/>	SCHNEIDERS
<input type="checkbox"/>	STRAUSS
<input type="checkbox"/>	VOORDE
<input type="checkbox"/>	WARREN

THE WHITE HOUSE

WASHINGTON

Date: August 5, 1977

MEMORANDUM

FOR ACTION:

Jack Watson
Charlie Schultze

FOR INFORMATION:

The Vice President
Hamilton Jordan
Jody Powell
Bert Lance
Z. Brzezinski

FROM: Rick Hutcheson, Staff Secretary

SUBJECT:

Stu Eizenstat/Bob Ginsburg memo 8/4/77
Re: The Trade Deficit (At President's Request)

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: NOON

DAY: MONDAY

DATE: AUGUST 8

ACTION REQUESTED:

Other: ☒ Your comments

STAFF RESPONSE:

☐ I concur. ☐ No comment.
Please note other comments below:

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required

THE WHITE HOUSE

WASHINGTON

August 4, 1977

MEMORANDUM FOR:

THE PRESIDENT

FROM:

STU EIZENSTAT
BOB GINSBURG

Stu

SUBJECT:

The Trade Deficit
(At Your Request)

This memorandum summarizes the accompanying papers on the trade deficit prepared by Treasury and Commerce.

DIMENSIONS OF THE TRADE DEFICIT

1. Size. The trade deficit is projected at \$27 billion for 1977 (\$149 billion in imports less \$122 billion in exports). The trade deficit was \$9 billion in 1976.

2. Trade Account and Current Account. The current account balance includes merchandise trade plus "invisible" items such as tourism, freight and transportation, investment income, and unilateral transfer payments; it measures a country's net balance in international transactions. Invisibles are projected to be in surplus by \$11.5 billion in 1977 (\$8 billion in 1976). Accordingly, the current account should be in deficit by \$15.5 billion in 1977 (\$1 billion deficit in 1976). Although the current account is a more inclusive measure, the trade account is considered by many to be more important because it depends on the export of goods and, accordingly, is more directly related to job creation.

3. Geographical Distribution. All the projected 1977 trade deficit can be accounted for by deficits the U.S. will be running with OPEC countries. The U.S. will be in rough balance with the non-OPEC world as a whole. However, the deterioration in the U.S. trade balance between 1976 and 1977 is accounted for partly by a deficit in our trade balance with Mexico and Brazil, our fourth and tenth largest export markets (we normally run surpluses with these countries but they are currently embarked on domestic stabilization policies), and a somewhat larger than usual deficit with Hong Kong, Korea, Taiwan, Japan and Canada (we normally run trade deficits with all these countries).

4. Product Distribution. The U.S. will run a \$40 billion deficit (\$45 billion in imports, \$5 billion in exports) in fuels (oil, gas, coal, nuclear fuel) in 1977 and a surplus of approximately \$13 billion in all other products. However, although oil is by far the most important, it is not the only problem. The traditional U.S. trade surplus in manufactured goods will decline from about \$19 billion in 1976 to \$13 billion in 1977.

5. Lag in Exports. While imports were up 26% in 1976 and are expected to increase by another 20% this year, exports increased only 7% in 1976 and are expected to increase only about 6% in 1977. Since these changes include price increases, the real volume of U.S. exports will be essentially flat for 1976 and 1977. Treasury attributes the imbalance between imports and exports basically to the oil situation and slower rates of economic growth abroad than in the U.S. Commerce is concerned that the lag in exports may also reflect some decline in international competitiveness of U.S. goods.

6. Prospects for the Future. The 1978 trade deficit is expected to be as large or larger than that for 1977. Although long-term projections must be considered with caution, Commerce expects a substantial trade imbalance to continue at least through 1980.

CAUSES OF THE TRADE DEFICIT

1. Oil. Fuel imports, up almost \$17 billion since 1975, are the most important factor in the trade deficit. And, because of the inability of OPEC countries to absorb all the imports which they originally ordered for their economic development plans, U.S. exports to OPEC countries have slowed from annual gains up to 70% in the 1973-1975 period to approximately 15%.

In a global context in which the oil-importing countries as a group must run deficits to absorb the \$40-\$45 billion OPEC surplus, there is a sense in which the U.S. movement from current account surplus in 1975 to rough balance in 1976 to a \$15.5 billion deficit in 1977 has been "appropriate" -- without that movement, the financially weaker countries (both developed and LDCs) might be running unsustainable deficits which could be handled only by sharp and destabilizing changes in their domestic economic policies. However, of the financially stronger countries (U.S., Japan, West Germany, Switzerland, and the Netherlands), only the U.S. is doing its part in assisting adjustment to the international consequences of the OPEC surplus. (To be sure, some of our

"strong" allies might argue that we are not doing our part where it counts most -- cutting back substantially on imported oil.)

The slow growth and current account surpluses in West Germany, Switzerland, and the Netherlands are particularly hurting the "weak" countries of Scandinavia, France, the U.K., and Southern Europe. Only expanding markets in all the strong countries will allow the world economy to achieve a steady sustainable growth path.

2. Favorable Economic Growth in the U.S. and Slow Growth Abroad. Nearly 1/2 of the deterioration in our trade balance between 1976 and 1977 is accounted for by non-oil trade (e.g., the \$6 billion decline in our surplus in manufactured goods). This is a function primarily of the relatively strong U.S. economic recovery, which has led to substantial increases in imports, and relatively slow growth abroad, which has constrained our exports.

The impact of differential growth rates on our trade balance is heightened by the fact that the U.S. has a higher marginal propensity to import than our trading partners, i.e., a 1% increase in U.S. income will lead to a roughly 2% increase in our imports while the relationship is roughly 1:1 for our trading partners. (This is because (i) the principal U.S. imports, other than oil, are consumer goods which are more heavily dependent upon changes in income than the agriculture goods and capital goods which we export and (ii) imports constitute a smaller share of our consumption pattern than they do for our trading partners and, accordingly, are more flexible upward.)

It is not only West Germany and Japan that are growing slowly but a number of non-oil LDCs, which are embarked on domestic stabilization policies to reduce their debt and get their economies in balance and which have to pay an increasing part of their foreign exchange for oil. U.S. exports to non-oil LDCs, even in inflated dollars, have been virtually flat for the past two years.

3. U.S. Competitiveness. Making judgments about changes in competitiveness over relatively short time periods is a risky business, depending crucially on the base period chosen. Commerce points out that the appreciation of the dollar between mid-1974 and early 1976 caused U.S. manufactured goods to lose some of their "competitiveness." With a 1-2 year normal lag in the impact of changes in

relative prices on manufacturing exports, this "decline" in "competitiveness" may presently be having some adverse effect on manufacturing exports and may continue to do so for the next year or so.

However, Treasury points out that since early 1976 U.S. inflation has been lower than the average inflation rates experienced by our major trading partners and, therefore, in terms of relative prices the U.S. has probably made some small gains in "competitiveness" recently. Commerce also notes that most foreign governments do considerably more to promote and even subsidize exports than does the U.S.

The U.S. share of world manufacturing exports was 20.3% in 1976, down from 21.2% in the cyclically high year of 1975 but up from the 19.1% historic low point of 1972.

IMPLICATIONS OF THE TRADE DEFICIT

1. Economic Implications. Lagging exports have an obvious adverse effect on economic growth, jobs, and Federal tax revenues. To the extent that the sharp increase in imports is due to unfair competition from abroad, U.S. industry is being hurt and domestic production impaired. Beyond these truisms, there is general agreement that it is appropriate international economic policy for the U.S. to be running a trade deficit at this time. The questions relate to the size and persistence of the deficit and our ability to sustain it over time, if necessary, without adverse economic or political fallout. Commerce believes that "persistent, excessive" U.S. trade deficits would tend to create uncertainty and instability in the world and U.S. economies, with attendant political risks.

2. Political-Psychological Implications. To some, a trade deficit and a depreciating dollar are inherent signs of weakness. To others, they are potent arguments for import restraints (which, in turn, could severely jeopardize our efforts to control inflation). Short run "fixes" for the trade deficit (e.g., import restrictions or slowing down economic growth through monetary and fiscal policy or through import quotas on oil) would be worse than the problem itself.

POSSIBLE RESPONSES TO THE TRADE DEFICIT

1. Short Run. There is little we can do which will substantially reduce the trade deficit over the next year or two. Those policies which would work -- such as import restrictions or cutting back on domestic economic growth -- are inherently undesirable.

2. Recommendations. Treasury and Commerce are in basic agreement on a fairly standard set of responses to the trade deficit:

- (a) an energy program which will reduce oil imports;
- (b) encouraging the "strong" countries (Japan, West Germany, Switzerland, and the Netherlands) to expand their economies and allow their exchange rates to rise;
- (c) acting against specific cases of dumping or unfair foreign trade practices;
- (d) increasing official IMF resources to enable other countries to adjust to their oil problems at reasonable, non-deflationary paces;
- (e) pursuing the reduction of barriers to U.S. exports in the MTN;
- (f) increasing the export awareness of U.S. producers and increasing the promotion of U.S. exports;
- (g) adequate export financing (Commerce supports an expansion of the Export-Import Bank and DISC; Treasury, believing that U.S. goods have not lost their competitiveness and that lagging exports are primarily a function of slow foreign growth, would not go as far in expanding the ExIm Bank and thinks DISC contributes virtually nothing and should be eliminated); and
- (h) educating the U.S. public on the problem in order to reduce the possibility of ill-advised political reactions.

3. Additional Responses. Although not mentioned in the Treasury or Commerce papers, we would add the following to the list of possible responses:

- (a) We are running trade deficits with a number of countries which are nominally LDCs -- Korea, Taiwan, Hong Kong, Mexico, and Brazil -- but which have really developed beyond the need for special trade preferences, import controls, and strong export subsidization. We could insist that these countries begin to play by the rules of the game and, in particular, adopt less protectionist import policies and reduce their export subsidization.

(b) If the trade deficit persists and you determine that more vigorous action needs to be taken, you should seek advice from Secretaries Vance and Brown and Dr. Brzezinski on possible diplomatic/political responses to encourage more equitable policies by the "strong" countries and those listed in (a) above. The Treasury and Commerce papers are concerned mainly with economic responses. Although diplomatic/political responses may be inappropriate now, there may come a time when we need to take a broader look at our options for dealing with the underlying problem of unbalanced economic policies among our allies (if not to cure our own trade deficit, for the stability of the "weak" countries of Europe).

(c) The IMF will meet in Washington in late September. All of the leading finance ministers, private bankers, etc. will be here. Normally the President makes brief, non-substantive welcoming remarks. You might use the occasion for a major substantive speech on international economic policy, describing the contribution the U.S. has made to world economic stability in the past few years and indicating that it is time for more equitable sharing of the burden of the oil deficit by all the strong economies.

The speech could have the positive international consequences of (i) putting all nations squarely on notice that the U.S. should not be expected to absorb the oil deficit alone and (ii) actually galvanizing our strong allies to adopt more equitable economic policies. It could also have the major domestic benefits of educating the American people and getting out in front in a leadership role on this issue.

THE WHITE HOUSE
WASHINGTON

HL

MEMORANDUM

Date: August 5, 1977

FOR ACTION:

Jack Watson
Charlie Schultze

FOR INFORMATION:

The Vice President
Hamilton Jordan
Jody Powell
Bert Lance
Z. Brzezinski



FROM: Rick Hutcheson, Staff Secretary

SUBJECT:

Stu Eizenstat/Bob Ginsburg memo 8/4/77
Re: The Trade Deficit (At President's Request)

YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:

TIME: NOON
DAY: MONDAY
DATE: AUGUST 8

ACTION REQUESTED:

Other: ☒ Your comments

STAFF RESPONSE:

☐ I concur.
Please note other comments below:

☒ No comment.

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

August 8, 1977

MEMORANDUM FOR: RICK HUTCHESON
Staff Secretary

FROM: Randy Jayne

SUBJECT: The Trade Deficit

Stu's memorandum on the trade balance issue is a good one, and correctly emphasizes that some actions taken now may have their impact two or three years hence when they may not be needed. Two important factors not dealt with by Stu's memo, and which bear directly on the trade balance, are;

- the current regime of floating exchange rates which should correct any competitive imbalances which may exist; and,
- the role of capital flows which, barring active U.S. exchange rate intervention, will offset and may be partly responsible for any current account imbalance.

We generally agree with the recommended Treasury/Commerce measures outlined in the memorandum. We support Treasury in their view that intensified export promotion measures, especially Export-Import Bank lending, would be of very limited effectiveness in supporting a constructive balance of payments approach.

We are concerned about one point -- Stu's recommendation that special measures be taken with countries such as Brazil, Korea, Mexico and Taiwan. These countries were only recently or still are under major balance of payments pressure, which some believe to constitute a serious threat to the international monetary system. The actions they are taking to correct their own trade imbalances and to earn sufficient foreign exchange to pay off heavy short-term debt are mostly necessary to restore stability to their external accounts. The U.S. should avoid measures which might disrupt those countries' short-term efforts to pull themselves up by the bootstraps.

OMB believes that the trade balance issue is sufficiently complex and important that before the President orders any significant action affecting the trade balance, he should have a full briefing by his economic advisors and the heads of the departments concerned.

THE WHITE HOUSE
WASHINGTON

August 12, 1977

The Vice President
Jack Watson
Bert Lance
Charlie Schultze
Zbig Brzezinski

The attached memorandum is
forwarded to you for your information.
If you wish to comment, please call
(x 7052) by the close of business today.

Rick Hutcheson

RE: TRADE DEFICIT MEMORANDUM

THE WHITE HOUSE
WASHINGTON

*Note: if you wish to comment
call by 08 Friday*

	FOR STAFFING
/	FOR INFORMATION
	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND

ACTION	FYI
	/
	MONDALE
	COSTANZA
	EIZENSTAT
	JORDAN
	LIPSHUTZ
	MOORE
	POWELL
/	WATSON
/	LANCE
/	SCHULTZE

	ENROLLED BILL
	AGENCY REPORT
	CAB DECISION
	EXECUTIVE ORDER

Comments due to
Carp/Huron within
48 hours; due to
Staff Secretary
next day

	ARAGON
	BOURNE
/	BRZEZINSKI
	BUTLER
	CARP
	H. CARTER
	CLOUGH
	FALLOWS
	FIRST LADY
	HARDEN
	HUTCHESON
	JAGODA
	KING

	KRAFT
	LINDER
	MITCHELL
	MOE
	PETERSON
	PETTIGREW
	POSTON
	PRESS
	SCHLESINGER
	SCHNEIDERS
	STRAUSS
	VOORDE
	WARREN

THE WHITE HOUSE

WASHINGTON

August 12, 1977

MEMORANDUM FOR:

THE PRESIDENT

FROM:

STU EIZENSTAT
BOB GINSBURG

Stu

SUBJECT:

The Trade Deficit
(At Your Request)

This memorandum summarizes the accompanying papers on the trade deficit prepared by Treasury and Commerce.

DIMENSIONS OF THE TRADE DEFICIT

1. Size. The trade deficit is expected to be about \$27 billion in 1977, an \$18 billion deterioration from the \$9 billion deficit for 1976. Imports are projected at approximately \$149 billion, with oil accounting for 30% of the total, and exports at \$122 billion.

2. Trade Account and Current Account. The current account balance includes the merchandise, agricultural products, and raw materials of the trade account as well as "invisible" items such as tourism, freight and transportation, investment income, and unilateral transfer payments; it measures a country's net balance in international transactions in goods, services, investment income, and transfer payments. Invisibles are projected to be in surplus by about \$11 1/2 billion in 1977 (\$8 billion in 1976). Accordingly, the current account should be in deficit by about \$15 1/2 billion (\$27 billion trade deficit less \$11 1/2 billion invisibles surplus) in 1977 (\$1 billion deficit in 1976).

Although less inclusive, the trade account is often given greater popular and political attention than the current account because in measuring the export and import of tangible products it is viewed by some as a better guide to the net impact of international trade on U.S. jobs. (That view is somewhat overdrawn because: (i) there is considerable labor content in such invisible items as tourism, freight, and banking and insurance services; (ii) there is relatively limited labor content in U.S. agricultural products, which account for roughly 20% of our exports; and (iii) about 50% of our imports are themselves necessary inputs for the production of goods in the U.S.)

3. Geographical Distribution. All the projected 1977 trade deficit can be accounted for by deficits the U.S. will be running with OPEC countries. The U.S. will be in rough balance with the non-OPEC world as a whole. However, the deterioration in the U.S. trade balance between 1976 and 1977 is accounted for partly by a deficit in our trade balance with Mexico and Brazil, our fourth and tenth largest export markets (we normally run surpluses with these countries but they are currently embarked on domestic stabilization policies), and a somewhat larger than usual deficit with Hong Kong, Korea, Taiwan, Japan and Canada (we normally run trade deficits with all these countries).

4. Product Distribution. The U.S. will run a \$40 billion deficit (\$45 billion in imports, \$5 billion in exports) in fuels (oil, gas, coal, nuclear fuel) in 1977 (\$32 billion deficit in 1976) and a surplus of approximately \$13 billion in all other products. In assessing the \$18 billion deterioration in our trade account between 1976 and 1977 on a product by product basis, the \$8 billion increase in fuels accounts for over 40% of the total and a decline in our surplus in manufactured goods from about \$19 billion in 1976 to \$13 billion in 1977 accounts for another 1/3.

5. Lag in Exports. While imports were up 26% in 1976 and are expected to increase by another 20% this year, exports increased only 7% in 1976 and are expected to increase only about 6% in 1977. Since these changes include price increases, the real volume of U.S. exports will be essentially flat for 1976 and 1977. Treasury attributes the imbalance between imports and exports basically to the oil situation and slower rates of economic growth abroad than in the U.S. Commerce is concerned that the lag in exports may also reflect some decline in international competitiveness of U.S. goods.

6. Prospects for the Future. The 1978 trade deficit is expected to be as large or larger than that for 1977. Although long-term projections must be considered with caution, Commerce expects a substantial trade imbalance to continue at least through 1980.

CAUSES OF THE TRADE DEFICIT

1. Oil. Fuel imports, up almost \$17 billion since 1975, are the most important factor in the trade deficit. The oil export revenues of the OPEC countries as a group are so huge that, even with large percentage increases in imports, they are running current account surpluses in the range of \$40-\$45 billion.

In a global context in which the oil-importing countries as a group must run deficits to absorb the \$40-\$45 billion OPEC surplus, the U.S. movement from current account surplus in 1975 to rough balance in 1976 to a \$15 1/2 billion deficit in 1977 has been "appropriate" -- without that movement, the financially weaker countries (both developed and LDCs) might be running unsustainable deficits which could be handled only by sharp and destabilizing changes in their domestic economic policies. However, of the financially stronger countries (U.S., Japan, West Germany, Switzerland, and The Netherlands), only the U.S. is doing its part in assisting adjustment to the international consequences of the OPEC surplus. (To be sure, some of our "strong" allies might argue that we are not doing our part where it counts most -- cutting back substantially on imported oil.)

The slow growth and current account surpluses in West Germany, Switzerland, and The Netherlands are particularly damaging to the "weak" countries of Scandinavia, France, the U.K., and Southern Europe. Only expanding markets in all the strong countries will allow the world economy to achieve a steady, sustainable growth path.

2. Favorable Economic Growth in the U.S. and Slow Growth Abroad. More than 1/2 of the \$18 billion deterioration in our trade balance between 1976 and 1977 is accounted for by non-oil trade (e.g., the \$6 billion decline in our surplus in manufactured goods). This is a function primarily of the relatively strong U.S. economic recovery, which has led to substantial increases in imports, and relatively slow growth abroad, which has constrained our exports.

The impact of differential growth rates on our trade balance is heightened by the fact that U.S. imports respond more sharply to changes in U.S. income than our exports respond to changes in foreign income, i.e., a 1% increase in U.S. income will lead to a 1.5 - 2.0% increase in our imports while a 1% increase in foreign income will only lead to a 1.0 - 1.5% increase in U.S. exports. (This is because (i) the U.S. imports a large amount of consumer goods, which are more heavily dependent upon changes in income than the agricultural products and capital goods which we export and (ii) imports constitute a smaller share of our consumption pattern than they do for our trading partners and, accordingly, are more flexible upward.)

It is not only West Germany and Japan that are growing slowly but virtually all of Europe and a number of non-oil LDCs. Some of the "weak" countries of Europe and the non-oil LDCs are embarked on domestic stabilization policies to reduce their debt and get

their economies in balance and also have to pay an increasing part of their foreign exchange for oil. U.S. exports to non-oil LDCs, even in inflated dollars, have been virtually flat for the past two years.

3. U.S. Competitiveness. Any judgments about changes in competitiveness over relatively short time periods must be inherently conjectural because the conclusions reached will depend crucially on the base period chosen. Commerce points out that the export prices of U.S. manufactured goods increased relative to those of our trading partners during the period between mid-1974 and early 1976. With a 1-2 year normal lag in the impact of changes in relative prices on manufacturing exports, this "decline" in "competitiveness" may presently be having some adverse effect on manufacturing exports and may continue to do so for the next year or so.

However, Treasury points out that since early 1976 U.S. inflation has been lower than the average inflation rates experienced by our major trading partners and, therefore, in terms of relative prices the U.S. has probably made some small gains in "competitiveness" recently. Commerce also notes that most foreign governments do considerably more to promote and even subsidize exports than does the U.S.

The U.S. share of world manufacturing exports was 20.3% in 1976, down from 21.2% in the cyclically high year of 1975 but up from the 19.1% historic low point of 1972.

IMPLICATIONS OF THE TRADE DEFICIT

1. Economic Implications. Lagging exports have an obvious adverse effect on economic growth, jobs, and Federal tax revenues. To the extent that the sharp increase in imports (at a time when U.S. unemployment and excess capacity are high) is due to unfair competition from abroad, U.S. industry is being hurt and domestic production impaired. Beyond these truisms, there is general agreement that it is appropriate international economic policy for the U.S. to be running a current account deficit at this time. The questions relate to the causes, size, and persistence of the deficit and our ability to sustain it over time, if necessary, without adverse economic or political fallout.

Commerce believes that "persistent, excessive" U.S. trade deficits would tend to create uncertainty and instability in the world and U.S. economies, with attendant political risks.

Treasury notes that the ratio of the present current account deficit to U.S. GNP is about the same as that for the OECD as a whole (about 1% in each case) and that the U.S., with its strong economy and capital markets and stable political system, is better able to finance and manage a deficit than almost all other countries. Treasury believes that our focus should be on reducing the oil problem and urging the other "strong" countries to expand their economies, that the U.S. competitive position remains strong, and that the U.S. should not take measures which would attempt to improve our trade balance at the expense of our trading partners.

2. Political-Psychological Implications. To some, a trade deficit and a depreciating dollar are inherent signs of weakness. To others, they are potent arguments for import restraints (which, in turn, could severely jeopardize our efforts to control inflation). Although these views may have to be met in the political arena with public education, they are without economic merit. Short run "fixes" for the trade deficit (e.g., import restrictions or slowing down economic growth through monetary and fiscal policy or through import quotas on oil) would be worse than the problem itself.

POSSIBLE RESPONSES TO THE TRADE DEFICIT

1. Short Run. There is little we can do which will substantially reduce the trade deficit over the next year or two. Those policies which would work -- such as import restrictions or cutting back on domestic economic growth -- are inherently undesirable.

2. Recommendations. Treasury and Commerce are in basic agreement on the following set of responses to the trade deficit:

- (a) an energy program which will reduce oil imports;
- (b) encouraging the "strong" countries (Japan, West Germany, Switzerland, and The Netherlands) to expand their economies, thereby increasing their imports;
- (c) encouraging the "strong" countries to allow their exchange rates to rise, thereby reducing the price competitiveness of their exports (that kind of automatic adjustment is a basic purpose of floating exchange rates but it can be thwarted by government intervention in the exchange markets);

- (d) acting against specific cases of dumping or unfair foreign trade practices;
- (e) increasing official IMF resources to enable other countries to adjust to their oil problems at reasonable paces without forcing destabilizing cutbacks in their domestic economic policies;
- (f) pursuing the reduction of barriers to U.S. exports in the MTN and in direct consultation with countries like Japan;
- (g) increasing the export awareness of U.S. producers and increasing the promotion of U.S. exports;
- (h) adequate export financing (Commerce supports an expansion of the Export-Import Bank and DISC; Treasury, believing that U.S. goods have not lost their competitiveness and that export subsidization would both undermine our efforts to reduce these practices by others and provoke retaliation, would not go as far in expanding the ExIm Bank and thinks DISC contributes virtually nothing and should be eliminated); and
- (i) educating the U.S. public on the problem in order to reduce the possibility of ill-advised political reactions.

3. Additional Responses. Although not mentioned in the Treasury or Commerce papers, we would add the following to the list of possible responses:

- (a) If the trade deficit persists and you determine that more vigorous action needs to be taken, you should seek advice from Secretary Vance and Dr. Brzezinski on possible diplomatic/political responses to encourage more equitable policies by the "strong" countries. The Treasury and Commerce papers are concerned mainly with economic responses. We know that we are pushing Japan and West Germany fairly hard already and would not recommend any additional pressure for now, but there may come a time when we need to take a broader look at our options for dealing with the underlying problem of unbalanced economic policies among our allies (probably less for reasons of our own trade deficit than to protect the stability of the "weak" countries of Europe).

- (b) The IMF will meet in Washington in late September. All of the leading finance ministers, private bankers, etc. will be here. Normally the President makes brief, non-substantive welcoming remarks. You might use the occasion for a major substantive speech on international economic policy, describing the contribution the U.S. has made to world economic stability in the past few years and indicating that it is time for more equitable sharing of the burden of the oil deficit by all the strong economies.

The speech could have the positive international consequences of (i) putting all nations squarely on notice that the U.S. should not be expected to absorb the oil deficit alone and (ii) actually galvanizing our strong allies to adopt more equitable economic policies. It could also have the major domestic benefits of educating the American people and getting out in front in a leadership role on this issue.